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No. 10-185

IN THE
Supreme Court of the United States

CORE COMMUNICATIONS, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI
(VOLUME I OF III)

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TABLE OF CONTENTS

Page

Volume I

Appendix A – Court of Appeals Opinion in *Core Communications, Inc.* v. *FCC*, 592 F.3d 139 (D.C. Cir. 2010) 1a

Appendix B – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 15a

Volume II

Appendix B (continued) – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 399a

Volume III

Appendix C – Court of Appeals Opinion in *In re Core Communications, Inc.*, 531 F.3d 849 (D.C. Cir. 2008) 792a

Appendix D – Court of Appeals Opinion in *In re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006) 819a

TABLE OF CONTENTS—Continued

Page

Appendix E – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. May 24, 2005) 847a

Appendix F – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. Nov. 22, 2004) 848a

Appendix G – Federal Communications Commission Order in *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the* ISP Remand Order, 19 F.C.C.R. 20,179 (Oct. 18, 2004) 849a

Appendix H – Court of Appeals Opinion in *WorldCom, Inc.* v. *FCC*, 288 F.3d 429 (D.C. Cir. 2002) 872a

Appendix I – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 F.C.C.R. 9151 (Apr. 27, 2001) 882a

Appendix J – Court of Appeals Opinion in *Bell Atlantic Telephone Cos.* v. *FCC*, 206 F.3d 1 (D.C. Cir. 2000) 1015a

TABLE OF CONTENTS—Continued

Page

Appendix K – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 F.C.C.R. 3689 (Feb. 26, 1999) 1032a

Appendix L – Court of Appeals Order Denying Panel Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010) 1085a

Appendix M – Court of Appeals Order Denying *En Banc* Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010) 1087a

Appendix N – Relevant Statutory Provisions 1089a

APPENDIX A
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

NOS. 08-1365, 09-1046, 08-1393, 09-1044

CORE COMMUNICATIONS, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

EARTHLINK, INC., ET AL.,
Intervenors,

ARGUED OCT. 16, 2009
DECIDED JAN. 12, 2010

On Petition for Review of Orders of the Federal Communications Commission

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Before: SENTELLE, Chief Judge, WILLIAMS and RANDOLPH, Senior Circuit Judges.

Opinion for the Court filed by Senior Circuit Judge WILLIAMS.

WILLIAMS, Senior Circuit Judge:

When a customer accesses the internet via "dial-up," his or her call goes to a local exchange carrier ("LEC"), which commonly hands the call off to another LEC,

which in turn connects the customer to an internet service provider ("ISP").[1] The ISP links the customer to the web. At least as early as 1999 the Federal Communications Commission was concerned that the regulatory procedures under which the sending LEC compensated the recipient LEC were leading to the imposition of excessive rates, and that these rates in turn were distorting the markets for internet and telephone services. The Commission in due course responded with an alternative regulatory regime, principally taking the form of rate caps set well below the rates that had prevailed before.

In the order under review here, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic* (CC Docket Nos. 96-45, 96-98, 99-68, 99-200, 01-92), FCC 08-262, 24 FCC Rcd. 6475, 2008 WL 4821547 (Nov. 5, 2008) (the "*Order*"), the Commission has set forth the basis of its authority to institute the rate cap system, namely, 47 U.S.C. § 201. That section (excerpted in an appendix to this opinion) requires that the charges of "every common carrier engaged in interstate or foreign communication by wire" for "such communication service" be "just and reasonable," and authorizes the Commission to "prescribe such rules and regulations as may be necessary . . . to carry out the provisions of this chapter." *Id.* Petitioners assail the Commission's analysis on a variety of grounds, most powerfully on the theory that §§ 251-252 of Title 47, added by the Telecommunications Act of 1996, Pub. L.

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[1] Data in the record suggest that dial-up, though being rapidly replaced by various forms of higher-speed service, still accounts for a non-trivial share of internet access: about 20.4% in 2007, 10.5% in 2009, and (a prediction, obviously) 4.6% in 2014. Joint Appendix 102.

No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151-714 (the "1996 Act"), withdraw from the Commission whatever support § 201 might have afforded its rate cap decision. Finding no legal error in the Commission's analysis, we affirm its order.

* * *

Before the FCC imposed a rate cap system, rates for the transfer of calls from an originating LEC to the ISP's LEC were governed, in practice, by the "reciprocal compensation" provisions of the 1996 Act. That act, in the interest of opening the telephone market to competition, had imposed a number of obligations on all local exchange carriers, including a duty to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). Reciprocal compensation arrangements require that when a customer of one carrier makes a local call to a customer of another carrier (which uses its facilities to connect, or "terminate," that call), the originating carrier must compensate the terminating carrier for the use of its facilities. See *In re Core Communications, Inc.*, 455 F.3d 267, 270 (D.C. Cir. 2006) ("*Core 2006*"). Subsection 251(c) imposes extra duties on "incumbent local exchange carriers" ("ILECs"). (ILECs are a subset of LECs, comprising mainly the Bell Operating Companies that succeeded to the local operations of AT&T on the occasion of the latter's dissolution as a result of an antitrust settlement. See *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982). "Competitive local exchange carriers" ("CLECs") constitute the remainder of the LEC universe.) Among the § 251(c) obligations is a "duty to negotiate in good faith in accordance with [§ 252] the particular terms and conditions of agreements to fulfill the duties described in" § 251(b), including the reciprocal

compensation obligations, and to provide interconnection with its own "network" for requesting telecommunications carriers. 47 U.S.C. § 251(c). Section 252 allows ILECs to satisfy their § 251 obligations by privately negotiating terms with CLECs, but also grants parties the right to refer the negotiations to state commissions for mediation or arbitration.

The *Order* arises out of the Commission's concern with the results of applying the reciprocal compensation system to ISP-bound traffic, a concern perhaps most clearly expressed in an order responding to our initial remand of the matter:

> Because traffic to ISPs flows one way, so does money in a reciprocal compensation regime. . . . It was not long before some LECs saw the opportunity to sign up ISPs as customers and collect, rather than pay, compensation because ISP modems do not generally call anyone. . . . In some instances, this led to classic regulatory arbitrage that had two troubling effects: (1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services, potentially driving ISP rates to consumers to uneconomical levels.

Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic, 16 FCC Rcd 9151, 2001 WL 455869 (April 27, 2001) (the "*ISP Remand Order*") ¶ 21.

The Commission's first step into this arena was its issuance of *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689, 1999 WL 98037 (Feb. 26, 1999) ("*Declaratory Ruling*"). There it applied its so-called "end-to-end" analysis (as it does in the order under review), under which the classification of a communication as local or interstate turns on whether its origin and destination are in the same state. Because a customer's venture into the web characteristically reaches servers out of state (and often out of the country), the Commission concluded that under the end-to-end principle dial-up internet traffic was interstate. *Id.* ¶ 18. As such traffic was "jurisdictionally mixed," *id.* ¶ 19, however, the Commission chose not to disturb state commissions' application of interconnection agreements to that traffic "pending adoption of a rule establishing an appropriate interstate compensation mechanism," *id.* at ¶ 21. In review of the order in *Bell Atlantic Tel[]. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000), we found the Commission's conclusions in apparent conflict with various prior statements, and possibly with the statute; we vacated the order and remanded the matter for its further analysis. *Id.* at 9.

On remand the Commission instituted substantially the same rate cap system that it defends here. See *ISP Remand Order* ¶ 8. But it claimed as supporting authority 47 U.S.C. § 251(g), which required LECs to comply with certain FCC regulations promulgated prior to the enactment of the 1996 Act. In *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), we rejected that claim, finding that § 251(g) was "worded simply as a transitional device" and thus could not be relied on for authority to promulgate new regulations. *Id.* at 430. Recognizing

that the Commission's rules might well have other legal bases, however, we did not vacate the order. *Id.* at 430, 434.

Between the *ISP Remand Order* and the present *Order* there have been several additional visits to our court. In July 2003 Core Communications, Inc. ("Core") petitioned the FCC to forbear from enforcing its rate caps and associated provisions, a petition that the FCC partly granted. *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, 19 FCC Rcd 20179, ¶¶ 23-24, ¶ 27, 2004 WL 2341235 (Oct. 18, 2004). We upheld the order against challenges by both CLECs and ILECs. *Core 2006*, 455 F.3d 267.

In June 2004 Core filed a petition seeking mandamus requiring the FCC to respond to the *WorldCom* remand. Based on the FCC's representations about its efforts to meet the remand, we denied Core's petition "without prejudice to refiling in the event of significant additional delay." *In re: Core Communications, Inc.*, No. 04-1179 (D.C. Cir. May 24, 2005). In October 2007 Core filed a second petition, which we granted, "direct[ing] the FCC to explain the legal basis for its ISP-bound compensation rules within six months of" May 5, 2008. *In re Core Communications, Inc.*, 531 F.3d 849, 850 (D.C. Cir. 2008) ("*Core 2008*").

On the last permissible day, November 5, 2008, the FCC released the current *Order*. Petitions for review followed, filed by Core and by Public Service Commission of the State of New York and National Association of Regulatory Utility Commissioners (the "state petitioners"); we consolidated the petitions.

* * *

As we noted at the outset, the Commission relies primarily on § 201 for its authority to regulate ISP-bound traffic. See *Order* ¶ 21. That section prohibits carriers engaged in the delivery of interstate communications from charging rates that are not "just and reasonable," and grants the FCC authority to prescribe regulations to implement the 1934 Act, which include all provisions of the 1996 Act. See *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-78, 119 S. Ct. 721, 142 L. Ed. 2d 835 (1999) (observing that "Congress expressly directed that the 1996 Act . . . be inserted into the Communications Act of 1934" and holding that "the grant in § 201(b) means . . . [that] [t]he FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252"). A savings clause attached to § 251, namely § 251(i), fortifies the Commission's position, providing: "Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201." Further, all parties agree that the familiar principles of *Chevron USA v. Natural Resources Defense Council*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), apply to the FCC's construction of the Communications Act. State Pet'rs Br. 8; Core Pet'r Br. 27-28; Resp. Br. 19-20. Finally, except as discussed below, the petitioners accept the end-to-end analysis and its application to ISP-bound calls, as announced by the Commission in the *Declaratory Ruling* in 1999 (described above) and restated in the *Order*, ¶ 21 & n.69.

Against the Commission's reliance on § 201, petitioners claim that "Congress's specific choice" on the matter of interLEC compensation, manifested in §§ 251-252, must trump the FCC's "general rulemaking authority under section 201." Core Interv. Br. 18. They cite *Norwest Bank Minnesota National Association v. FDIC*,

312 F.3d 447, 451 (D.C. Cir. 2002), for the "cardinal rule of statutory construction . . . that where both a specific and a general provision cover the same subject, the specific provision controls." State Pet'r Br. 27.

But it is inaccurate to characterize § 201 as a general grant of authority and §§ 251-252 as a specific one. "When . . . two statutes apply to intersecting sets . . . , neither is more specific." *Hemenway v. Peabody Coal Co.*, 159 F.3d 255, 264 (7th Cir. 1998). That is the case here. Not all inter-LEC connections are used to deliver interstate communications, just as not all interstate communications involve an inter-LEC connection. A local call to chat with a schoolmate about the evening's homework would not—at least under conditions typical today—involve interstate communications; and a conventional interstate long distance call, while it will usually involve interconnection between the long distance provider and a LEC, will often not involve two LECs connecting directly with each other. And, as to a LEC's provision of access for completion of a long-distance call, the parties agree that the link between the LEC and the interexchange carrier is *not* governed by the reciprocal compensation regime of § 251(b)(5). See State Pet'rs Br. 25-26 (citing *Global NAPS, Inc. v. Verizon New England*, 444 F.3d 59, 62-63 (1st Cir. 2006), in turn quoting the FCC's *Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 1996 WL 452885 (Aug. 8, 1996)).

Dial-up internet traffic is special because it involves interstate communications that are delivered through local calls; it thus simultaneously implicates the regimes of both § 201 and of §§ 251-252. Neither regime is a subset of the other. They intersect, and dial-up internet traffic falls within that intersection. Given this overlap,

§ 251(i)'s specific saving of the Commission's authority under § 201 against any negative implications from § 251 renders the Commission's reading of the provisions at least reasonable.

Petitioners next argue that because the call to the ISP terminates locally, the FCC's authority over interstate communications is inapplicable. State Pet'r Br. 30-33. Section 251(b)(5) applies to "reciprocal compensation arrangements for the transport and termination of telecommunications." Petitioners point to the FCC's definition (in the *Order*) of "terminat[ion]" as "the switching of traffic that is subject to Section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises." See *Order* ¶ 13; see also 47 C.F.R. § 51.701(d). State Pet'rs Br. 31-32. Because the "called party" in the case of dial-up Internet traffic is the ISP, petitioners say, the § 251(b)(5) telecommunications "terminat[e]" locally and thus the FCC cannot apply its § 201 authority over these communications.

This argument fails because it implicitly assumes inapplicability of the end-to-end analysis, which petitioners have not challenged. And the FCC has consistently applied that analysis to determine whether communications are interstate for purposes of § 201. Petitioners do not dispute that dial-up internet traffic extends from the ISP subscriber to the internet, or that the communications, viewed in that light, are interstate. Given that ISP-bound traffic lies at the intersection of the § 201 and §§ 251-252 regime, it has no significance for the FCC's § 201 jurisdiction over interstate communications that these telecommunications might be deemed to "terminat[e]" at a LEC for purposes of § 251(b)(5).

Petitioners also appear indirectly to invoke the 8th Circuit's conclusion that while the FCC has authority to

impose a *methodology* on state commissions' exercise of power under § 252 (they specifically note "total element long-run incremental cost" ("TELRIC")), it has (for certain purposes) no power to set actual prices. See State Pet'rs Br. 33, citing *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000). We take no position on the issue before the 8th Circuit. It reached its finding for purposes quite different from the present subject (FCC ratesetting authority for a leg of an interstate communication), and it did not address the FCC's power to implement "just and reasonable" rates under § 201 or how that power was affected by §§ 251-252.

Petitioners further argue that it was "arbitrary and capricious" for the FCC to "discriminate" against dial-up internet traffic by requiring that LECs be compensated pursuant to the rate cap regime when terminating such traffic, but otherwise in accordance with state commissions' application of the FCC's TELRIC methodology. Core Pet'r Br. 43-47; Core Interv. Br. 22-23. See 5 U.S.C. § 706(2)(A). Our review under the arbitrary and capricious standard is narrow. See *Core 2006*, 455 F.3d at 277. Here the agency action passes handily.

The Commission has provided a solid grounding for the differences between the treatment of inter-LEC compensation for delivery of dial-up internet traffic and the regime generally applicable to inter-LEC compensation under § 251(b)(5). (We assume *arguendo* that the concept of discrimination is relevant to regimes created under entirely different statutory provisions.) In the context to which reciprocal compensation is ordinarily applied, it noted, outgoing calls are generally balanced by incoming ones, so that it matters relatively little how accurately rates reflect costs. *ISP Remand Order* ¶ 69. Such balance is utterly absent from ISP-bound traffic.

Moreover, the Commission found that in fact the rates for such traffic were so distorted that CLECs were in effect paying ISPs to become their customers. *Id.* ¶ 70 & n.134; see also *id.* ¶ 21. To the extent that ILECs simply passed the costs on to their customers generally (rather than having a separate charge for those making ISP-bound calls), they would force their noninternet customers to subsidize those making ISP-bound calls, and the system would send inaccurate price signals to those using their facilities for internet access (in effect the ISPs and their customers) and to those not doing so. *Id.* ¶¶ 68, 87. On the other hand, the Commission believed that its "failure to act . . . would lead to higher rates for Internet access, as ILECs seek to recover their reciprocal compensation liability . . . from their customers to call ISPs," *id.* ¶ 87, presumably meaning rates "higher" than cost, correctly computed. Thus the continued application of the reciprocal compensation regime to ISP-bound traffic would "undermine[ ] the operation of competitive markets." *Id.* ¶ 71.

Core purports to find a discrepancy between our mandamus order and the Commission's response. Our order required the FCC to "explain[ ] the legal authority for the Commission's interim intercarrier compensation rules that exclude ISP-bound traffic from the reciprocal compensation requirement of § 251(b)(5)." *Core 2008*, 531 F.3d at 862. The *Order*, en route to finding that § 201 authorized the Commission to impose its rate cap system on the communications in question, also expressed its view that they *were* "subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2)." Order ¶ 15; see also *id.* ¶ 16. Core claims that in so finding the Commission violated our mandate.

In context it is perfectly plain that our order sought simply to have the FCC explain the reasoning underlying its exercise of authority, not to preempt its analytical route. The sort of argument made by Core here gives pettifoggery a bad name.

Finally, we note the presence of a number of arguments introduced outside of the petitioners' opening briefs. Core intervened in the appeal filed by the state petitioners before we consolidated its separate appeal with the latter. Together with other intervenors, Core filed a brief raising a number of arguments that it did not raise as petitioner. As we explained in *Illinois Bell Telephone Company v. FCC*, 911 F.2d 776 (D.C. Cir. 1990), "An intervening party may join issue only on a matter that has been brought before the court by another party." *Id.* at 786 (emphasis added). While we acknowledged in *Synovus Financial Corporation v. Board of Governors*, 952 F.2d 426 (D.C. Cir. 1991), that this rule is prudential and "should not be applied categorically," the grounds that *Synovus* mentioned for making exceptions are absent here. *Id.* at 434. *Synovus* allowed an intervenor who lacked incentive to petition for review of the administrative action to present an additional issue that was "an essential predicate to [a] question" raised by petitioners. *Id.* at 434 (internal quotes omitted). But Core not only had an incentive to petition for review itself but did so. See *United States Telephone Association v. FCC*, 188 F.3d 521, 531 (D.C. Cir. 1999) (noting that intervenors not only failed to qualify for the *Synovus* exception but "present[ed] no reason why it could not have petitioned in its own right"). And the issues Core raises as intervenor bear "no substantive connection" to the challenges petitioners raise in their initial briefs. *Synovus*, 952 F.2d at 434; Cir. Rule 28(d)(2). Accordingly, we

do not consider the new arguments Core raises as intervenor. Similarly, we do not consider arguments that first appear in petitioners' reply briefs. See, e.g., *Bd. of Regents of the Univ. of Washington v. EPA*, 86 F.3d 1214, 1221 (D.C. Cir. 1996) ("By failing to make any specific objection until their reply brief, petitioners deprived the [respondents] of the opportunity to respond. To prevent this . . . , we have generally held that issues not raised until the reply brief are waived.").

* * *

The petitions for review are

Denied.

Appendix: Text of 47 U.S.C. § 201

§ 201. Services and Charges.

(a) It shall be the duty of every *common carrier engaged in interstate or foreign communication by wire or radio* to furnish such communication service upon reasonable request therefor[ ]; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

(b) *All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable*, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful: Provid-

ed, That communications by wire or radio subject to this chapter may be classified into day, night, repeated, unrepeated, letter, commercial, press, Government, and such other classes as the Commission may decide to be just and reasonable, and different charges may be made for the different classes of communications. . . . *The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter.*

47 U.S.C. § 201 (emphasis added).

APPENDIX B
BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FCC 08-262

IN THE MATTER OF

HIGH-COST UNIVERSAL SERVICE SUPPORT
WC DOCKET NO. 05-337

FEDERAL-STATE JOINT BOARD
ON UNIVERSAL SERVICE
CC DOCKET NO. 96-45

LIFELINE AND LINK UP
WC DOCKET NO. 03-109

UNIVERSAL SERVICE CONTRIBUTION METHODOLOGY
WC DOCKET NO. 06-122

NUMBERING RESOURCE OPTIMIZATION
CC DOCKET NO. 99-200

IMPLEMENTATION OF THE LOCAL COMPETITION
PROVISIONS IN THE TELECOMMUNICATIONS ACT OF 1996
CC DOCKET NO. 96-98

DEVELOPING A UNIFIED INTERCARRIER COMPENSATION REGIME
CC DOCKET NO. 01-92

INTERCARRIER COMPENSATION FOR ISP-BOUND TRAFFIC
CC DOCKET NO. 99-68

IP-ENABLED SERVICES
WC DOCKET NO. 04-36

ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING

ADOPTED: NOVEMBER 5, 2008
RELEASED: NOVEMBER 5, 2008

Comment Date:	**(14 days after publication in the Federal Register)**
Reply Comment Date:	**(21 days after publication in the Federal Register)**

By the Commission: Chairman Martin issuing a separate statement; Commissioners Copps, Adelstein, Tate, and McDowell issuing a joint statement.

TABLE OF CONTENTS

Paragraph No.

I. ORDER ON REMAND – ISP-BOUND TRAFFIC 1
A. Background 2
B. Discussion 6
1. Scope of Section 251(b)(5) 7
2. Authority Under Section 201 17
3. Other Issues 23
II. REPORT AND ORDER – REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT 30
A. Background 31
B. Discussion 37
III. FURTHER NOTICE OF PROPOSED RULEMAKING 38
IV. PROCEDURAL MATTERS 42
A. *Ex Parte* Presentations 42
B. Comment Filing Procedures 43
C. Initial Regulatory Flexibility Analysis 51
D. Paperwork Reduction Act 52
E. Accessible Formats 53
F. Congressional Review Act 54
V. ORDERING CLAUSES 55
APPENDIX A – Chairman's Draft Proposal
APPENDIX B – [omitted]
APPENDIX C – Alternative Proposal
APPENDIX D – [omitted]
APPENDIX E – Initial Regulatory Flexibility Analysis

I. ORDER ON REMAND – ISP-BOUND TRAFFIC

1. The actions we take in this order respond to the writ of mandamus granted by the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) directing the Commission to respond to its prior remand of the Commission's intercarrier compensation rules for Internet Service Provider (ISP)-bound traffic.[1] As discussed below, we conclude that we have authority to impose ISP-bound traffic rules.

A. Background

2. On February 26, 1999, the Commission issued a Declaratory Ruling and Notice of Proposed Rulemaking in which it held that ISP-bound traffic is jurisdictionally interstate because end users access websites across state lines.[2] Because the *Local Competition First Report and Order* concluded that the reciprocal compensation obligation in section 251(b)(5) applied only to local traffic, the Commission found in the *Declaratory Ruling* that ISP-bound traffic is not subject to section 251(b)(5).[3] On

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[1] *In re Core Communications, Inc.*, 531 F.3d 849, 861-62 (D.C. Cir. 2008) (directing the Commission to respond to the remand in the form of a final, appealable order which explains its legal authority to issue the pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*).

[2] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Declaratory Ruling and Notice of Proposed Rulemaking, 14 FCC Rcd 3689 (1999) (*Declaratory Ruling*), *vacated and remanded*, *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

[3] *See also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 16013, paras. 1033-34 (1996) (subsequent history omitted) (*Local Competition First Report and Order*).

March 24, 2000, in the *Bell Atlantic* decision, the D.C. Circuit vacated certain provisions of the *Declaratory Ruling*.[4] The court did not question the Commission's finding that ISP-bound traffic is interstate. Rather, the court held that the Commission had not adequately explained how its end-to-end jurisdictional analysis was relevant to determining whether a call to an ISP is subject to reciprocal compensation under section 251(b)(5).[5] In particular, the court noted that a LEC serving an ISP appears to perform the function of "termination" because the LEC delivers traffic from the calling party through its end office switch to the called party, the ISP.[6]

3. On April 27, 2001, the Commission released the *ISP Remand Order*, which concluded that section 251(g) excludes ISP-bound traffic from the scope of section 251(b)(5).[7] The Commission explained that section 251(g) maintains the pre-1996 Act compensation requirements for "exchange access, information access, and exchange services for such access," thereby excluding such traffic from the reciprocal compensation requirements that the 1996 Act imposed.[8] The Commission concluded that ISP-

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[4] *Bell Atlantic*, 206 F.3d at 1.

[5] *See id.* at 5.

[6] *See id.* at 6.

[7] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9171-72, para. 44 (2001) (*ISP Remand Order*), *remanded but not vacated by WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002) (*WorldCom*) (subsequent history omitted) (holding that section 251(g) appears to provide for the continued enforcement "of certain pre-Act regulatory 'interconnection restrictions and obligations'").

[8] The term "1996 Act" refers to the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). The term "Act" refers to the Communications Act of 1934, as amended. 47 U.S.C. § 151 *et seq.*

bound traffic was "information access" and, therefore, was subject instead to the Commission's section 201 jurisdiction over interstate communications.[9] The Commission also found "convincing evidence in the record" that carriers had "targeted ISPs as customers merely to take advantage of . . . intercarrier payments" (including offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud). It therefore adopted an ISP payment regime in order to "limit, if not end, the opportunity for regulatory arbitrage."[10] The Commission concluded that a bill-and-keep regime might eliminate incentives for arbitrage and force carriers to look to their own customers for cost recovery.[11] To avoid a flash cut to bill-and-keep, however, the Commission adopted a compensation regime pending completion of the *Intercarrier Compensation* proceeding.[12] Specifically, the regime adopted by the Commis-

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[9] *See ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. Thus, the Commission affirmed its prior finding in the *Declaratory Ruling* that ISP-bound traffic is jurisdictionally interstate. *See id; see also Declaratory Ruling*, 14 FCC Rcd at 3710-03, paras. 18-20.

[10] *See ISP Remand Order*, 16 FCC Rcd at 9187, para. 77.

[11] *ISP Remand Order*, 16 FCC Rcd at 9184-85, paras. 74-75. The Commission discussed at length the market distortions and regulatory arbitrage opportunities created by the application of per-minute reciprocal compensation rates to ISP-bound traffic. In particular, the Commission found that requiring compensation for this type of traffic at existing reciprocal compensation rates undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers, thereby distorting the price signals sent to their ISP customers. *See ISP Remand Order*, 16 FCC Rcd at 9181-86, paras. 67-76.

[12] *See ISP Remand Order*, 16 FCC Rcd at 9153, para. 2 (citing *Developing a Unified Intercarrier Compensation Regime*, CC

sion consisted of: (1) a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use; (2) a growth cap on total ISP-bound minutes for which a LEC may receive this compensation; (3) a "new markets rule" requiring bill-and-keep for the exchange of this traffic if two carriers were not exchanging traffic pursuant to an interconnection agreement prior to the adoption of the regime; and (4) a "mirroring rule" that gave incumbent LECs the benefit of the rate cap only if they offered to exchange all traffic subject to section 251(b)(5) at the same rates.[13] These rate caps reflected the downward trend in intercarrier compensation rates contained in then-recently negotiated interconnection agreements.[14]

4. On May 3, 2002, the D.C. Circuit found that the Commission had not provided an adequate legal basis for the rules it adopted in the *ISP Remand Order*.[15] Once again, the court did not question the Commission's finding that ISP-bound traffic is jurisdictionally interstate. Rather, the court held that section 251(g) of the Act did not provide a basis for the Commission's decision. The court held that section 251(g) is simply a transitional

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Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*)).

[13] *ISP Remand Order*, 16 FCC Rcd at 9187-89, 9193-94, paras. 78, 80, 89. In a subsequent order, the Commission granted forbearance to all telecommunications carriers with respect to the growth caps and the new markets rule. *See Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, Order, 19 FCC Rcd 20179 (2004) (*Core Forbearance Order*). Thus, only the rate caps and mirroring rule remain in effect today.

[14] *See ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85.

[15] *See WorldCom*, 288 F.3d at 429.

device that preserved obligations that predated the 1996 Act until the Commission adopts superseding rules, and that there was no pre-1996 Act obligation with respect to intercarrier compensation for ISP-bound traffic.[16] Although the court rejected the legal rationale for the compensation rules, the court remanded, but did not vacate, the *ISP Remand Order* to the Commission, and it observed that "there is plainly a non-trivial likelihood that the Commission has authority" to adopt the rules.[17] Accordingly, the rules adopted in the *ISP Remand Order* have remained in effect.

5. On November 5, 2007, Core filed a petition for writ of mandamus with the D.C. Circuit seeking to compel the Commission to enter an order resolving the court's remand in the *WorldCom* decision.[18] On July 8, 2008, the court granted a writ of mandamus and directed the Commission to respond to the *WorldCom* remand in the form of a final, appealable order which explains its legal authority to issue the pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*.[19] The court directed the Commission to respond to the writ of mandamus by November 5, 2008.[20]

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[16] *See id.* at 433.

[17] *See id.* at 434.

[18] Pet. for Writ of Mandamus to the Federal Communications Commission, D.C. Cir. 07-1446 (filed Nov. 5, 2007).

[19] *Core Communications, Inc.*, 531 F.3d at 861-62.

[20] *See id.* If the Commission fails to comply with the writ by the November 5th deadline, the rules will be vacated on November 6, 2008. *See id.* at 862.

B. Discussion

6. In this order, we respond to the D.C. Circuit's remand order in *WorldCom v. FCC*,[21] and the court's writ of mandamus in *Core Communications Inc.*[22] Specifically, we hold that although ISP-bound traffic falls within the scope of section 251(b)(5), this interstate, interexchange traffic is to be afforded different treatment from other section 251(b)(5) traffic pursuant to our authority under section 201 and 251(i) of the Act.

1. Scope of Section 251(b)(5)

7. As an initial matter, we conclude that the scope of section 251(b)(5) is broad enough to encompass ISP-bound traffic. To be sure, we acknowledge that, in the *Local Competition First Report and Order*, the Commission found that section 251(b)(5) applies only to local traffic,"[23] and some commenters continue to press for such an interpretation.[24] As other commenters recognize,

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[21] *See* 288 F.3d at 434.

[22] *See* 531 F.3d at 861-62.

[23] *Local Competition First Report and Order*, 11 FCC Rcd at 16012-13, para. 1033.

[24] *See, e.g.*, Supplemental Comments of Verizon and Verizon Wireless at 24-32; Letter from Daniel Mitchell, Vice President, Legal and Industry, National Cable and Telecommunications Association (NCTA), to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9 (filed Sept. 30, 2008) (NCTA Sept. 30, 2008 *Ex Parte* Letter); Verizon *Intercarrier Compensation FNPRM* Comments at 38-42; NARUC *Intercarrier Compensation FNPRM* Comments at 6-7; Rural Alliance *Intercarrier Compensation FNPRM* Comments at 144-49; Cincinnati Bell *Intercarrier Compensation FNPRM* Comments at 5-11; Maine Public Utilities Commission and Vermont Public Service Board *Intercarrier Compensation FNPRM* Comments at 7; New York State Department of Public Service *Intercarrier Compensation FNPRM* Comments at 7; Verizon and BellSouth, Supplemental White Paper on ISP Reciprocal Compensation, CC Docket No. 96-98, 99-68 at 16-20 (filed July 20, 2004) (Verizon/BellSouth

however, the Commission, in the *ISP Remand Order*, reconsidered that judgment and concluded that it was a mistake to read section 251(b)(5) as limited to local traffic, given that "local" is not a term used in section 251(b)(5).[25] We recognize, as the Supreme Court noted in *AT&T Corp. v. Iowa Utilities Board*, that "[i]t would be a gross understatement to say that the 1996 Act is not a model of clarity."[26] Nevertheless, we find that the better view is that section 251(b)(5) is not limited to local traffic.

8. We begin by looking at the text of the statute. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[27] The Act broadly defines "telecommunications" as "the transmission, between or among points specified by the user, of

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Supp. ISP White Paper); NARUC's Initial Comments at 7 n.13 (May 23, 2004). *But see, e.g.*, ICF *Intercarrier Compensation FNPRM* Comments at 39.

[25] *ISP Remand Order*, 16 FCC Rcd at 9166-67, para. 35. *See also, e.g.*, Qwest, Legal Authority for Comprehensive Intercarrier Compensation Reform 2-4 (Qwest White Paper), *attached to* Letter from Melissa Newman, Counsel for Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 06-45, 99-68, WC Docket Nos. 04-36, 05-337, 05-195, 06-122 (filed Oct. 7, 2008) (Qwest Oct. 7, 2008 *Ex Parte* Letter); Letter from Kathleen O'Brien Ham et al., Counsel for T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9-10 (filed Oct. 3, 2008) (T-Mobile Oct. 3, 2008 *Ex Parte* Letter); Level 3 Aug. 18, 2008 *Ex Parte* Letter at 2, 15-18; AT&T Reply to *Comment Sought on Missoula Plan Phantom Traffic Interim Process Call Detail Records Proposal*, CC Docket No. 01-92, Public Notice, DA 06-2294 (WCB 2006) (*Missoula Phantom Traffic*) at 35-41; Brief from Gary M. Epstein, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 29-35 (filed Oct. 5, 2004).

[26] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 397.

[27] 47 U.S.C. § 251(b)(5).

information of the user's choosing, without change in the form or content of the information as sent and received."[28] Its scope is not limited geographically ("local," "intrastate," or "interstate") or to particular services ("telephone exchange service,"[29] telephone toll service,"[30] or "exchange access"[31]). We find that the traffic we elect to bring within this framework fits squarely within the meaning of "telecommunications." We also observe that had Congress intended to preclude the Commission from bringing certain types of telecommunications traffic within the section 251(b)(5) framework, it could have easily done so by incorporating restrictive terms in section 251(b)(5). Because Congress used the term "telecommunications," the broadest of the statute's defined terms, we conclude that section 251(b)(5) is not limited only to the transport and termination of certain types of telecommunications traffic, such as local traffic.

9. In the *Local Competition First Report and Order* the Commission concluded that section 251(b)(5) applies only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge."[32] In the *ISP Remand Order*, the Commission reversed course on the scope of section 251(b)(5), finding that "the phrase 'local traffic' created unnecessary ambiguities, and we correct that mistake here."[33] The *ISP Remand Order*

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[28] 47 U.S.C. § 153(43).

[29] *Id.* § 153(47).

[30] *Id.* § 153(48).

[31] *Id.* § 153(16).

[32] *Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033.

[33] *ISP Remand Order*, 16 FCC Rcd at 9173, para. 46.

noted that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)."[34] The Commission found that the scope of section 251(b)(5) is limited only by section 251(g), which temporarily grandfathered the pre-1996 Act rules governing "exchange access, information access, and exchange services for such access" provided to interexchange carriers and information service providers until "explicitly superseded by regulations prescribed by the Commission."[35] On appeal, the D.C. Circuit left intact the Commission's findings concerning the scope of section 251(b)(5), although it took issue with other aspects of the *ISP Remand Order*.[36]

10. We disagree with commenters who argue that section 251(b)(5) only can be applied to traffic exchanged between LECs, and not traffic exchanged between a LEC and another carrier.[37] The Commission rejected

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[34] *Id.* at 9167, para. 34.

[35] 47 U.S.C. § 251(g).

[36] *See WorldCom v. FCC*, 288 F.3d at 429.

[37] *See, e.g.*, Supplemental Comments of Verizon and Verizon Wireless ("The best interpretation of § 251(b)(5)—read in light of the text, structure, and history of the 1996 Act—is that the reciprocal compensation obligation applies only to intraexchange (or 'local') voice calls that originate on the network of one LEC (or wireless provider) and terminate on the network of another LEC (or wireless provider) operating in the same exchange (or, in the case of wireless providers, the same MTA."); Letter from Ann D. Berkowitz, Associate Director, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 26 (filed May 17, 2004) (attaching white paper entitled "Internet-Bound Traffic is Not Compensable Under Sections 251(b)(5) and 252(d)(2)") (Verizon/BellSouth White Paper) ("By its nature, 'reciprocal compensation' must [ ] apply to 'telecommunications' exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is

that argument in the *Local Competition Order*, finding that section 251(b)(5) applies to traffic exchanged by a LEC and any other telecommunications carrier, and adopted rules implementing that finding.[38] In a specific application of that principle, the Commission concluded that "CMRS providers will not be classified as LECs,"[39] but nevertheless found that "LECs are obligated, pursuant to section 251(b)(5) (and the corresponding pricing standards of section 252(d)(2)), to enter into reciprocal compensation agreements with all CMRS providers."[40] No one challenged that finding on appeal, and it has been settled law for the past 12 years. We see no reason to revisit that conclusion now. While section 251(b)(5) indisputably imposes the duty to establish reciprocal compensation arrangements on LECs alone, Congress did not limit the class of potential beneficiaries of that obligation to LECs.[41]

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authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs.") (emphasis in original).

[38] *See Local Competition First Report and Order*, 11 FCC Rcd at 16013-16, paras. 1034-41. *See also* 47 C.F.R. 51.703(a) ("Each LEC shall establish reciprocal compensation arrangements for transport and termination of telecommunications traffic with any requesting telecommunications carrier"); *ISP Remand Order*, 16 FCC Rcd at 9193-94, para. 89 n.177 ("Section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier . . . .").

[39] *Local Competition First Report and Order*, 11 FCC Rcd at 15996, para. 1005.

[40] *Local Competition First Report and Order*, 11 FCC Rcd at 15997, para. 1008.

[41] If Congress had intended to limit the class of potential beneficiaries of LECs' duty to establish reciprocal obligation arrangements, it would have said so explicitly. *See* 47 U.S.C. § 251(b)(3) (describing the "duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service").

11. We also disagree with commenters who argue that section 252(d)(2)(A)(i) limits the scope of section 251(b)(5).[42] Section 252(d)(2)(A)(i) provides that a state commission "shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless "such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[43] Verizon and others argue that this provision necessarily excludes interexchange traffic from the scope of section 251(b)(5), because at the time the 1996 Act was passed calls neither originated nor terminated on an interexchange carrier's network.[44] We reject this reasoning because it erroneously assumes that Congress intended the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5). We do not believe that Congress intended the tail to wag the dog.

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[42] *See, e.g.*, Verizon/BellSouth White Paper at 41-43; New York State Department of Public Service *Intercarrier Compensation FNPRM* Comments at 8-9; TDS *Intercarrier Compensation FNPRM* Comments at 19 n.27; VeriSign *Intercarrier Compensation FNPRM* Comments, Attach B. at 9, 12, 26-28; Qwest *Intercarrier Compensation FNPRM* Comments at 39; NASUCA *Intercarrier Compensation FNPRM* Reply at 17; Leap Wireless International, Inc. *Intercarrier Compensation FNPRM* Reply, Ex. 5 at 8.

[43] 47 U.S.C. § 252(d)(2)(A)(i).

[44] *See, e.g.*, Maine Public Utilities Commission and Vermont Public Service Board *Intercarrier Compensation FNPRM* Comments at 7-8; New York State Department of Public Service *Intercarrier Compensation FNPRM* Comments at 7-10; Verizon/BellSouth Supp. ISP White Paper at 16-20; NARUC *Intercarrier Compensation FNPRM* Initial Comments at 7 n.13.

12. Section 251(b)(5) defines the scope of traffic that is subject to reciprocal compensation. Section 252(d)(2)(A)(i), in turn, deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies. Section 252(d)(2)(A)(i) provides that, at a minimum, a reciprocal compensation arrangement must provide for the recovery by each carrier of costs associated with the transport and termination on each carrier's network of calls that originate on the network of the other carrier.[45] Section 252(d)(2)(A)(i) does not address what happens when carriers exchange traffic that originates or terminates on a third carrier's network. This does not mean, as Verizon suggests, that section 251(b)(5) must be read as limited to traffic involving only two carriers. Rather, it means that there is a gap in the pricing rules in section 252(d)(2), and the Commission has authority under section 201(b) to adopt rules to fill that gap.

13. We also reject Verizon's argument that a telecommunications carrier that delivers traffic to an ISP is not eligible for reciprocal compensation because the carrier does not "terminate" telecommunications traffic at the ISP.[46] In the *Local Competition Order*, the Commission defined "termination" as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises."[47] As the D.C. Circuit suggested in the *Bell Atlantic* decision, "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose

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[45] 47 U.S.C. § 252(d)(2)(A)(i).

[46] *See, e.g.*, Supplemental Comments of Verizon and Verizon Wireless at 33-34; Verizon/BellSouth White Paper at 31-32.

[47] *Local Competition Order*, 11 FCC Rcd at 16015, para. 1040. *See also* 47 C.F.R. § 51.701(d).

customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"[48] We agree.[49]

14. Verizon also argues that the reference to reciprocal compensation in the competitive checklist in section 271,[50] which was designed to ensure that local markets are open to competition, somehow shows that Congress intended to limit the scope of section 251(b)(5) to local traffic.[51] We do not see how this argument sheds any light on the scope of section 251(b)(5). Congress no doubt included the reference to reciprocal compensation in section 271 because section 251(b)(5) applies to local traffic, a point that no one disputes. That does not suggest, however, that section 251(b)(5) applies *only* to local traffic.

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[48] 206 F.3d at 6.

[49] We reject Verizon's argument against the application of section 251(b)(5) to ISP-bound traffic because this traffic is one-way traffic and as such is not reciprocal, *see* Supplemental Comments of Verizon and Verizon Wireless at 26 (Oct. 2, 2008); Verizon White Paper at 41-43 (May 17, 2004). As Level 3 points out, these arguments have been rejected by the Commission and the U.S. Court of Appeals for the Ninth Circuit. *See* Level 3 Aug. 18, 2008 *Ex Parte* Letter at 18; *Pacific Bell v. Cook Telecom, Inc.*, 197 F.3d 1236, 1242-44 (9th Cir. 1999) (reciprocal compensation applies to paging traffic); *TSR Wireless, LLC v. U.S. West Communications, Inc.*, 15 FCC Rcd 11166, 11178 para. 21 (2000) (the Commission's reciprocal compensation rules "draw [] no distinction between one-way and two-way carriers"). Because our conclusion in this order concerning the scope of section 251(b)(5) is no longer tied to whether this traffic is local or long distance, we need not address arguments made by the parties as to whether ISP-bound traffic constitutes "telephone exchange service" under the Act. *See e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 99-68, 96 98, Attach. at 1 (filed Sept. 24, 2004).

[50] *See* 47 U.S.C. § 271(c)(2)(B)(xiii).

[51] *See* Supplemental Comments of Verizon and Verizon Wireless at 26; Verizon/BellSouth White Paper at 9.

15. We need not respond to every other variation of the argument that the history and structure of the Act somehow demonstrate that section 251(b)(5) is limited to local traffic. At best, these arguments show that one plausible interpretation of the statute is that section 251(b)(5) applies only to local traffic, a view that the Commission embraced in the *Local Competition First Report and Order*. These arguments do not persuade us, however, that this is the only plausible reading of the statute. Moreover, many of the same arguments based on the history and context of the adoption of section 251 to limit its scope to local traffic were rejected by the D.C. Circuit in the context of section 251(c).[52] We find that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2).

16. Notwithstanding section 251(b)(5)'s broad scope, we agree with the finding in the *ISP Remand Order* that traffic encompassed by section 251(g) is excluded from

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[52] *United States Telecom Association v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) *(USTA II), cert. denied sub nom., Nat'l Ass'n of Regulatory Utility Comm'rs v. United States Telecom Ass'n*, 543 U.S. 925, 125 S. Ct. 313, 160 L. Ed. 2d 223 (2004) ("Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not 'telecommunications services' has no support."). In *USTA II*, the D.C. Circuit was addressing whether the term "telecommunications services" was limited to local telecommunications services under section 251(c), while here we consider the analogous question of whether "telecommunications" is limited to local telecommunications under section 251(b).

section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope. Section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation."[53] Here, however, the D.C. Circuit has held that ISP-bound traffic did not fall within the section 251(g) carve out from section 251(b)(5) as "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic."[54] As a result, we find that ISP-bound traffic falls within the scope of section 251(b)(5).

2. Authority Under Section 201

17. The section 251(b)(5) finding above, however, does not end our legal analysis here. That is because the ISP-bound traffic at issue here is clearly interstate in nature and thus also subject to our section 201 authority. The Commission unquestionably has authority to regulate intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and other traffic subject to Commission authority such as ISP-bound traffic. Section 2(a) of the Act establishes the Commission's jurisdiction over interstate services, for which the Commission ensures just, reasonable, and not unjustly and unreasonably discriminatory rates under section 201 and 202.[55] Likewise, the Commission has authority over the rates of CMRS providers pursuant to section 332 of the Act.[56]

18. In sections 251 and 252 of the Act, Congress altered the traditional regulatory framework based on jur-

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[53] 47 U.S.C. 251(g).

[54] *WorldCom*, 288 F.3d at 433.

[55] 47 U.S.C. §§ 152(a), 201, 202.

[56] 47 U.S.C. § 332.

isdiction by expanding the applicability of national rules to historically intrastate issues and state rules to historically interstate issues.[57] In the *Local Competition First Report and Order*, the Commission found that the 1996 Act created parallel jurisdiction for the Commission and the states over interstate and intrastate matters under sections 251 and 252.[58] The Commission and the states "are to address the same matters through their parallel jurisdiction over both interstate and intrastate matters under sections 251 and 252."[59] Moreover, section 251(i) provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[60] In the *Local Competition First Report and Order*, the Commission concluded that section 251(i) "affirms that the Commission's preexisting authority under section 201 continues to apply for purely interstate activities."[61]

19. In implementing sections 251 and 252 in the *Local Competition First Report and Order*, the Commission's treatment of LEC-CMRS traffic provides an instructive example. Prior to the 1996 Act, the Commission expressly preempted "state and local regulations of the kind of interconnection to which CMRS providers are entitled" based on its authority under section 201 and 332 of the Act.[62] Nevertheless, in the *Local Competition First Report and Order*, the Commission brought LEC-

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[57] *Local Competition First Report and Order*, 11 FCC Rcd at 15544, para. 83.

[58] *Id.* at 15544-45, para. 85.

[59] *Id.*

[60] 47 U.S.C. § 251(i).

[61] *Local Competition First Report and Order* at 15546-47, para. 91.

[62] *Implementation of Sections 3(n) and 332*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd 1411, 1498, para. 230 (1994).

CMRS interconnection within the section 251 framework as it relates to intraMTA (including interstate intraMTA) traffic.[63] The Commission recognized, however, that it continued to retain separate authority over CMRS traffic.[64]

20. Courts confirmed that, in permitting LEC-CMRS interconnection to be addressed through the section 251 framework, the Commission did not in any way lose its independent jurisdiction or authority to regulate that traffic under other provisions of the Act. Thus, although the Eighth Circuit invalidated the Commission's TELRIC pricing rules in general,[65] it recognized that "because section 332(c)(1)(B) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers, [including the reciprocal compensation rules] but only as these provisions apply to CMRS providers. Thus, [the pricing] rules . . . remain in full force and effect with respect to the CMRS providers, and our order of vacation does not apply to them in the CMRS context."[66] Subsequently, the D.C. Circuit held that CMRS providers were entitled to

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[63] *See Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023.

[64] *Id.* ("By opting to proceed under sections 251 and 252, we are not finding that section 332 jurisdiction over interconnection has been repealed by implication, or rejecting it as an alternative basis for jurisdiction.").

[65] We note that the Supreme Court later reversed this decision and affirmed the TELRIC methodology. *See Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467 (2002) (*Verizon v. FCC*).

[66] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (*Iowa Utils. I*) (vacated and remanded in part on other grounds, *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999) (*AT&T v. Iowa Utils. Bd.*)).

pursue formal complaints under section 208 of the Act for violations of the Commission's reciprocal compensation rules.[67]

21. We build upon our actions in the *Local Competition First Report and Order* and find here that addressing ISP-bound traffic through the section 251 framework does not diminish the Commission's independent jurisdiction or authority to regulate traffic under other provisions of the Act. Specifically, we retain our authority under section 201 to regulate ISP-bound traffic, despite acknowledging that such traffic is section 251(b)(5) traffic. With respect to interstate services, the Act has long provided us with the authority to establish just and reasonable "charges, practices, classifications, and regulations."[68] The Commission thus retains full authority to regulate charges for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework. Because we reaffirm our findings concerning the interstate nature of ISP-bound traffic, which have not been vacated by any court, it follows that such traffic falls under the Commission's section 201 authority preserved by the Act and that we therefore have the authority to issue pricing rules pursuant to that section.[69] This conclusion is reinforced

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[67] *See Qwest Corp. v. FCC*, 252 F.3d 462, 465-66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. Bd. v. FCC* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion).

[68] 47 U.S.C. § 201(b).

[69] We have consistently found that ISP-bound traffic is jurisdictionally interstate. ISP-bound traffic melds a traditional circuit-switched local telephone call over the PSTN to packet switched IP-based Internet communication to Web sites. *See e.g., Declaratory Ruling*, 14 FCC Rcd at 3702, para. 18; *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. This conclusion has not been questioned by the D.C.

by section 251(i) of the Act. As the Commission explained in the *ISP Remand Order*, section 251(i) "expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[70] It concluded that section 251(i), together with section 201,

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Circuit. *See WorldCom*, 288 F.3d at 431; *Bell Atlantic v. FCC*, 206 F.3d at 5 ("There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."). In other contexts, the Commission has likewise found that services that offer access to the Internet are jurisdictionally interstate services. In 1998, for example, the Commission found that ADSL service is jurisdictionally interstate. *See GTE Tel. Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22481, para. 28 (1998) ("finding that GTE's ADSL service is subject to federal jurisdiction" and is "an interstate service"). More recently, the Commission has confirmed this ruling for a variety of broadband Internet access services. *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4832, para. 59 (2002) (finding that, "on an end-to-end analysis," "cable modem service is an interstate information service"); *Wireline Broadband Internet Access Order*, 20 FCC Rcd 14853 at 14914, para. 110 (2005), *aff'd by Brand X*, 545 U.S. 967; *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT 07-53, Declaratory Ruling, 22 FCC Rcd 5901, 5911, para. 28 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, WC 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281, 13288, para. 11 (2006). In the *Vonage Order*, the Commission likewise found that VoIP services are jurisdictionally interstate, employing the same end-to-end analysis reflected in those other orders. *Vonage Order*, 19 FCC Rcd at 22413-14, paras. 17-18.

[70] *ISP Remand Order*, 16 FCC Rcd at 9174, para. 50.

equips the Commission with the tools necessary to keep pace with regulatory developments and new technologies.[71] When read together, these statutory sections preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic. Consequently, in the *ISP Remand Order*, the Commission properly exercised its authority under section 201(b) to issue pricing rules governing the payment of compensation between carriers for ISP-bound traffic.[72]

22. Our result today is consistent with the D.C. Circuit's opinion in *Bell Atlantic*, which concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under section 251(b)(5).[73] It is also consistent with the D.C. Circuit's *WorldCom* decision, in which the court rejected the Commission's view that section 251(g) excluded ISP-bound traffic from the scope of section 251(b)(5), but made no other findings.[74] Finally, this result does not run afoul of the Eighth Circuit's decision on remand from the Supreme Court in the *Iowa Utilities Board* litigation, which held that "the FCC does not have the authority to set the actual prices for the state commissions to use" under

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[71] *See ISP Remand Order*, at 9175, para. 51.

[72] We thus respond to the D.C. Circuit's remand order in *WorldCom*, 288 F.3d at 434, and the court's writ of mandamus in *Core Communications*, 531 F.3d at 861-62, which directed the Commission to explain its legal authority to issue the pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*. Specifically, we find, for the reasons set forth here that the Commission had the authority to adopt the pricing regime pursuant to our broad authority under section 201(b) to issue rules governing interstate traffic.

[73] *See Bell Atlantic*, 206 F.3d at 5.

[74] *See WorldCom*, 288 F.3d at 434.

section 251(b)(5).[75] At the time of that decision, under the *Local Competition First Report and Order*, section 251(b)(5) applied only to local traffic. Thus, the Eighth Circuit merely held that the Commission could not set reciprocal compensation rates for local traffic. The court did not address the Commission's authority to set reciprocal compensation rates for interstate traffic.[76] In sum, the Commission plainly has authority to establish pricing rules for interstate traffic, including ISP-bound traffic, under section 201(b), and that authority was preserved by section 251(i).

3. Other Issues

23. Most commenters urge the Commission to maintain the compensation rules governing ISP-bound traffic until the Commission is able to complete comprehensive intercarrier compensation reform.[77] These parties con-

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[75] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000) (*Iowa Utils. II*), *rev'd in part sub nom. Verizon v. FCC*, 535 U.S. 467.

[76] Indeed, above, the court expressly confirmed the Commission's independent authority to set rates for CMRS traffic pursuant to section 332 and declined to vacate the Commission's pricing rules as they applied in the context of CMRS service. *See Iowa Utils. I*, 120 F.3d at 800 n.21.

[77] *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337; CC Docket Nos. 96-45, 01-92, Attach. at 10 (filed July 8, 2008) (asking the Commission to maintain the existing compromises reached with respect to ISP-bound traffic); Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68 at 8 (filed May 9, 2008) (asserting that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform); Letter from L. Charles Keller, Counsel for Sage Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 99-68, 01-92, Attach. at 6 (Sage Telecom May 9, 2008 *Ex Parte* Letter) (stating that retaining the ISP rate serves broad policy

tend that a higher compensation rate would create new opportunities for arbitrage[78] and impose substantial financial burdens on wireless companies, incumbent LECs

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goals); Letter from John T. Nakahata, Counsel for Level 3 Communications to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 1 (filed May 7, 2008) (supporting continuation of the compensation rules); Letter from Joshua Seidmann, Vice President of Regulatory Affairs, Independent Telephone & Telecommunications Alliance, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 2 (filed Apr. 28, 2008) (ITTA Apr. 28, 2008 *Ex Parte* Letter) (asking the Commission to retain the current $0.0007 rate for ISP-bound traffic); Letter from Donna Epps, Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 (filed Apr. 7, 2008) (urging the Commission to support its earlier finding that $0.0007 is appropriate compensation for dial-up ISP traffic); Letter from L. Charles Keller, Counsel to Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, Attach. (filed May 1, 2008) (Verizon Wireless May 1, 2008 *Ex Parte* Letter) (describing how elimination of the existing ISP rate would create substantial burdens on a number of carriers and state commissions); Letter from Glenn Reynolds, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-262, WC Docket No. 07-135 at 2 (filed Apr. 29, 2008) (USTelecom Apr. 29, 2008 *Ex Parte* Letter) (noting that the Commission's existing rules have "largely mitigated the debate around compensation for ISP-bound traffic, but there is every reason to believe the same problems would arise if the Commission were to reverse direction on this issue").

[78] *See, e.g.*, USTelecom Apr. 29, 2008 *Ex Parte* Letter at 2; Letter from Melissa E. Newman, Vice President, Federal Regulatory, Qwest Communications International, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, WC Docket No. 07-135, Attach. at 3-5 (filed Apr. 25, 2008) (Qwest April 25, 2008 *Ex Parte* Letter); Verizon and BellSouth, Further Supplemental White Paper on ISP Reciprocal Compensation at 20 (Verizon/BellSouth Further Supp. ISP White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004).

and state public utility commissions.[79] They further claim that the existing regime has simplified interconnection negotiations.[80]

24. In the *ISP Remand Order*, the Commission found that the one-way nature of ISP-bound traffic creates significant arbitrage opportunities. Due to the unbalanced nature of ISP-bound traffic, the Commission observed that reciprocal compensation arrangements created enormous incentives for competitive LECs to sign up ISPs as customers.[81] The Commission cited evidence that competitive LECs, on average, terminated eighteen times more traffic than they originated, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, 90 percent of which was for ISP-bound traffic.[82] The Commission concluded that "the record strongly suggests that CLECs target ISPs in large part because of the availability of reciprocal compensation payments."[83] This undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers.[84] To limit arbitrage opportunities

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[79] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter, Attach.

[80] *See, e.g., id.* (stating that "the [m]irroring [r]ule simplified wireless-ILEC interconnection negotiations tremendously"); Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Docket Nos. 01-92, 96-98, 99-68 at 38-40 (filed Oct. 2, 2008) (Supplemental Comments of Verizon and Verizon Wireless) (indicating that Verizon entered into multiple agreements using the $.0007 rate cap established in the *ISP Remand Order*).

[81] *Id.* at 9182-83, para. 68-71.

[82] *Id.* at 9183, para. 70.

[83] *Id.*

[84] *Id.* at para. 71.

that arose from "excessively high reciprocal compensation rates,"[85] the Commission adopted a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute of use and declining to $.0007 per minute of use, the current cap.[86] The Commission derived the rate caps from contemporaneous interconnection agreements, in which carriers voluntarily agreed to rates comparable to the rate caps adopted by the Commission.[87] The interconnection agreements included lower rates for unbalanced traffic than for balanced traffic, and the rates declined over time, like the rate caps.[88] Although the Commission made no specific findings with regard to the actual costs associated with delivering traffic to ISPs, it noted evidence in the record that technological advances were reducing the costs incurred by carriers when handling all forms of traffic.[89] The Commission also noted that "negotiated reciprocal compensation rates continue to decline as ILECs and CLECs negotiate new agreements."[90]

25. On July 14, 2003, Core Communications, Inc. ("Core") filed a petition pursuant to Section 10 of the Communications Act[91] requesting that the Commission

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[85] *Id.* at 9185, para. 75.

[86] *Id.* at 9187, para. 78.

[87] *Id.* at 9190-91, para. 85.

[88] *Id.*

[89] *Id.* at 9190, para. 84.

[90] *Id.*

[91] *See* 47 U.S.C. § 160(a) ("[T]he Commission shall forbear from applying any regulation or any provision of [the Communications] Act to a telecommunications carrier ... if the Commission determines that (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications or regulations by, for, or in connection with that telecommunications carrier or tele-

forbear from enforcing the rate caps and certain other provisions set forth in the *ISP Remand Order* with respect to the exchange of ISP-bound traffic between telecommunications carriers. In 2004, the Commission denied the petition with respect to rate caps and the mirroring rule, determining that Core had satisfied none of the three prongs of the statutory test for forbearance.[92] First, the Commission found that forbearance from enforcement of the rate caps was not consistent with the public interest. To the contrary, the Commission concluded that rate caps remained necessary to prevent regulatory arbitrage and to promote efficient investment in telecommunications services and facilities.[93] Second, the Commission found limited potential for discrimination under the rate caps. The caps applied to ISP-bound traffic only to the extent that an incumbent carrier offered to exchange all traffic at the same rate under

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communications service are just and reasonable, and are not unjustly or unreasonably discriminatory; (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and (3) forbearance from applying such provision or regulation is consistent with the public interest.").

[92] *See Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(C) From Application of the ISP Remand Order*, 19 FCC Rcd 20179 (2004) ("*Forbearance Order*").

[93] The Commission rejected as an initial matter Core's argument that the D.C. Circuit's decision in *WorldCom, Inc. v. FCC*, 288 F.3d 429 (2002), *cert. denied*, 538 U.S. 1012 (2003), compelled the agency to grant the petition, observing that the court remanded but did not vacate the rules adopted in the *ISP Remand Order* and specifically found a "non-trivial likelihood" that the Commission would be able to justify the regime it adopted. *See Forbearance Order*, 19 FCC Rcd at 20185 para. 17 (quoting *Worldcom*, 288 F.3d at 434).

Section 251(b)(5).[94] Accordingly, the Commission concluded that Core had not proven that the rate caps resulted in impermissible discrimination against or between competitive carriers or services.[95] Finally, the Commission found that Core had not demonstrated that enforcement of the rate caps was not necessary for the protection of consumers. Core advanced speculative general claims that the caps caused artificially high rates, had forced competitive carriers from the market, and had deterred investment in telecommunications services, all to consumers' detriment. The Commission rejected these unsupported claims, explaining that the rate caps were designed to prevent the subsidization of dial-up Internet access customers at the expense of consumers of basic telephone service and to avoid regulatory arbitrage and discrimination between services.[96] For these reasons, the Commission denied Core's petition for forbearance insofar as rate caps were concerned.[97]

26. In 2006, the D.C. Circuit affirmed our decision not to forbear from the rate cap (and the mirroring rule).[98] The Court found reasonable the Commission's "view that the rate caps are necessary to prevent the subsidization of dial-up Internet access consumers by consumers of basic telephone service" that would occur if reciprocal compensation rates applied to one-way ISP-bound traffic.[99] The Court likewise rejected Core's contention that

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[94] *See* 47 U.S.C. § 251(b)(5) (imposing upon local exchange carriers the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications").

[95] *See Forbearance Order*, 19 FCC Rcd at 20187 para. 23.

[96] *Id.* at 20188 para. 25.

[97] *Id.* at 20189 para. 29.

[98] *In re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006).

[99] *Id.* at 278.

the rate cap was "unreasonably discriminatory," both because one-way ISP-bound calls were fundamentally different from other forms of traffic and because the mirroring rule ensures that "'the caps apply to ISP-bound traffic only if an incumbent LEC offers to exchange all Section 251(b)(5) traffic at the same rate.'"[100] Finally, the Court concluded that the Commission's concern that the rate cap was necessary to prevent "'regulatory arbitrage' and 'distorted economic incentives'" was reasonable.[101]

27. The policy justifications provided by the Commission in 2001 for the rules at issue here have not been questioned by any court. In addition, the policy justifications provided by the Commission for refusing to forbear from enforcement of these rules were upheld by the D.C. Circuit in 2006. We therefore disagree with parties who suggest that the Commission, in responding to the D.C. Circuit's remand in *WorldCom*, must offer detailed new justifications for the ISP intercarrier payment regime;[102] [w]e have already offered our justifications for that regime. Moreover, both the *WorldCom* remand and *Core* writ of mandamus focused on the issue of legal authority. We also reject arguments that the Commission unlawfully delegated its authority in the *ISP Remand Order* and arguments that the Commission addressed previously in the *Core Forbearance Order*.[103]

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[100] *Id.* (citing *Forbearance Order*, 19 FCC Rcd at 20187, para. 23).

[101] *Id.* at 279.

[102] *See* Letter from Michael B. Hazzard, Counsel to Core Communications, to Marlene H. Dortch, FCC, CC Docket Nos. 99-68, 01-92, Attach. at 20-26 (May 14, 2008).

[103] *See* Core May 14, 2008 Response at 18 & n.8, 19-20. The Commission did not delegate its authority in the *ISP Remand Order*, but rather provided options that were not mandatory. *See, e.g., ISP Remand Order*, 16 FCC Rcd at 9193, para. 89. Additionally, Core

28. The Commission long has stated its intention to move to a more unified intercarrier compensation regime. Progress is difficult due to competing priorities, such as competition, innovation, universal service, and other goals. The Commission recognized in 2001 that ISP-bound traffic represented a unique arbitrage problem that required immediate attention, based on the policy concerns discussed above. The Commission remains committed to moving towards a more unified intercarrier compensation regime, as evidenced by the Further Notice issued in conjunction with this order.

29. In sum, we maintain the $.0007 cap and the mirroring rule pursuant to our section 201 authority. These rules shall remain in place until we adopt more comprehensive intercarrier compensation reform.

II. REPORT AND ORDER – REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT

30. In this report and order, we address the "Recommended Decision" of the Federal-State Joint Board on Universal Service (Joint Board), which was released on November 20, 2007.[191] As discussed below, we appreciate the great efforts expended by the Joint Board and its staff in considering how best to reform the current high-cost support mechanism and in developing its recom-

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argues that the Commission provided no reasoned explanation for the growth cap and new markets rules adopted in the *ISP Remand Order* and never provided notice or an opportunity for comment on those specific rules. These rules, as applicable to all carriers, were forborne from in the *Core Forbearance Order*. *See Core Forbearance Order*, 19 FCC Rcd at 20186-87, paras. 20-21. As such, this argument is moot.

[191] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (JB 2007) (*Comprehensive Reform Recommended Decision*).

mendations. We choose not to implement the recommendations contained in the Comprehensive Reform Recommended Decision at this time, however.

A. Background

31. The 1996 Act amended the Communications Act of 1934 with respect to the provision of universal service.[105] In the 1996 Act, Congress sought to preserve and advance universal service, while at the same time opening all telecommunications markets to competition.[106] Section 254(b) of the Act directs the Joint Board and the Commission to base policies for the preservation and advancement of universal service on several general principles, plus other principles that the Commission may establish.[107] Among other things, section 254(b) directs that there should be specific, predictable, and sufficient federal and state universal service support mechanisms; quality services should be available at just, reasonable, and affordable rates; and access to advanced telecommunications and information services should be provided in all regions of the nation.[108]

32. The Commission implemented the universal service provisions of the 1996 Act in the 1997 *Universal Service First Report and Order*.[109] Among other things, the Commission adopted rules to create explicit universal service support mechanisms for customers living in rural and high cost areas. Pursuant to section 254(e) of the Act, an entity must be designated as an eligible telecom-

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[105] 47 U.S.C. § 254 (added by the 1996 Act).

[106] 47 U.S.C. § 254.

[107] *See* 47 U.S.C. § 254(b).

[108] 47 U.S.C. § 254(b)(1), (2), (5).

[109] *See Universal Service First Report and Order*, 12 FCC Rcd at 8780-88, paras. 1-20.

munications carrier (ETC) to receive high-cost universal service support.[110] ETCs may be incumbent LECs, or non-incumbent LECs, which are referred to as "competitive ETCs."[111] Under the existing high-cost support distribution mechanism, incumbent LEC ETCs receive high-cost support for their intrastate services based on their costs.[112] Competitive ETCs receive support for each line based on the support the incumbent LEC would receive for that line in the service area.[113] This support to competitive ETCs is known as "identical support." The Commission's universal service high-cost support rules do not distinguish between primary and secondary lines; therefore, high-cost support may go to a single end user for multiple connections.[114] Further, the Commission's rules result in subsidizing multiple competitors in the same high-cost area.

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[110] 47 U.S.C. § 254(e). The statutory requirements for ETC designation are set out in section 214(e) of the Act. 47 U.S.C. § 214(e).

[111] *See* 47 C.F.R. § 54.5 ("A 'competitive eligible telecommunications carrier' is a carrier that meets the definition of 'eligible telecommunications carrier' below and does not meet the definition of an 'incumbent local exchange carrier' in § 51.5 of this chapter.").

[112] Non-rural incumbent LEC ETCs receive support for their intrastate supported services based on the forward-looking economic cost of providing the services. 47 C.F.R. § 54.309. Rural incumbent LEC ETCs receive support based on their loop costs, as compared to a national average. 47 C.F.R. Part 36, sbpt. F; 47 C.F.R. § 54.305. Incumbent LEC ETCs that serve study areas with 50,000 or fewer lines receive support based on their local switching costs. 47 C.F.R. § 54.301. Additionally, incumbent LEC ETCs that are subject to price cap or rate-of-return regulation receive interstate access support based on their revenue requirements. 47 C.F.R. Part 54, sbpts. J, K.

[113] 47 C.F.R. § 54.307(a).

[114] *See Universal Service First Report and Order*, 12 FCC Rcd at 8828-30, paras. 94-96.

33. High-cost support for competitive ETCs has grown rapidly over the last several years, placing extraordinary pressure on the federal universal service fund.[115] In 2001, high-cost universal service support totaled approximately $2.6 billion.[116] By 2007, the amount of high-cost support had grown to approximately $4.3 billion per year.[117] In recent years, this growth has been due mostly to increased support provided to competitive ETCs, which receive high-cost support based on the per-line support that the incumbent LECs receive pursuant to the identical support rule. Competitive ETC support, in the six years from 2001 through 2007, has grown from under $17 million to $1.18 billion—an annual growth rate

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[115] Support for the fund derives from assessments paid by providers of interstate telecommunications services and certain other providers of interstate telecommunications. *See* 47 C.F.R. § 54.706. Fund contributors are permitted to, and almost always do, pass those assessments though to their end-user customers. *See* 47 C.F.R. § 54.712. Fund assessments paid by contributors are determined by applying the quarterly contribution factor to the contributors' contribution base revenues. In the second quarter of 2007, the contribution factor reached 11.7 percent, which is the highest level since its inception. *See Proposed Second Quarter 2007 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 22 FCC Rcd 5074, 5077 (OMD 2007). The contribution factor has since declined to 11.4% in the fourth quarter of 2008. *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD 2008).

[116] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 3.2 (2007) (2007 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://hraun-foss.fcc.gov/edocs_public/attachmatch/DOC-279226A1.pdf.

[117] UNIVERSAL SERVICE ADMINISTRATIVE COMPANY, 2007 ANNUAL REPORT 43 (2007) (USAC 2007 ANNUAL REPORT), *available at* http://www.usac.org/_res/documents/about/pdf/usac-annual-report-2007.pdf.

of over 100 percent.[118] This "funded competition" has grown significantly in a large number of rural, insular, or high-cost areas; in some study areas more than 20 competitive ETCs currently receive support.[119]

34. To address the growth in competitive ETC support, the Joint Board recommended an interim cap on the amount of high-cost support available to competitive ETCs, pending comprehensive high-cost universal service reform.[120] The Commission adopted this recommendation on May 1, 2008.[121]

35. For the past several years, the Joint Board and the Commission have been exploring ways to reform the Commission's high-cost program. In the most recent high-cost support comprehensive reform efforts, the

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[118] 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 3.2; USAC 2007 ANNUAL REPORT at 45.

[119] *See* USAC Quarterly Administrative Filings for 2008, Fourth Quarter (4Q) Appendices, HC03--Rural Study Areas with Competition—4Q2008, *available at* http://www.usac.org/about/governance/fcc-filings/2008/Q4/HC03%20-%20Rural%20Study%20Areas%20with%20Competition%20-%204Q2008.xls (showing 24 competitive ETCs in the study area of incumbent LEC Iowa Telecom North (study area code 351167), and 22 competitive ETCs in the study area of incumbent LEC Iowa Telecom Systems (study area code 351170)).

[120] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 8998, 8999-9001, paras. 4-7 (JB 2007) (*Interim Cap Recommended Decision*).

[121] *Interim Cap Recommended Decision*, 22 FCC Rcd at 8999-9001, paras. 4-7; *Interim Cap Order*, 23 FCC Rcd at 8834. As recommended by the Joint Board, the Commission capped competitive ETC support for each state. *Interim Cap Recommended Decision*, 22 FCC Rcd at 9002, para. 9; *Interim Cap Order*, 23 FCC Rcd at 8846, paras. 26 28. The Commission set the cap at the level of support competitive ETCs were eligible to receive during March 2008. *Interim Cap Order*, 23 FCC Rcd at 8850, para. 38.

Joint Board issued a recommended decision on November 20, 2007.[122] The Universal Service Joint Board's recommended decision included several recommendations to address the growth in high cost support and to reform the high cost mechanisms.[123] Specifically, the Universal Service Joint Board recommended that the Commission should: (1) deliver high-cost support through a provider of last resort fund, a mobility fund, and a broadband fund;[124] (2) cap the high-cost fund at $4.5 billion, the approximate level of 2007 high-cost support;[125] (3) reduce the existing funding mechanisms during a transition period;[126] (4) add broadband and mobility to the list of services eligible for support under section 254 of the Act;[127] (5) eliminate the identical support rule;[128] and (6) "explore the most appropriate auction mechanisms to determine high-cost universal service support."[129]

36. On January 29, 2008, the Commission released the *Joint Board Comprehensive Reform NPRM*, seeking comment on the Joint Board's *Comprehensive Reform*

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[122] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd 20477.

[123] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 1.

[124] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20480-81, para. 11.

[125] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26.

[126] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 27.

[127] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481-82, paras. 12-18.

[128] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20486, para. 35.

[129] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, paras. 1-6.

Recommended Decision.[130] Pursuant to section 254(a)(2), the Commission "shall complete any proceeding to implement subsequent recommendations from any Joint Board on universal service within one year after receiving such recommendations."[131]

B. Discussion

37. We have carefully reviewed the Joint Board's *Comprehensive Reform Recommended Decision* and the comments that were filed in response to the Commission's *Joint Board Comprehensive Reform NPRM*. We thank the Joint Board and its staff for their hard work in studying these difficult issues and in developing their recommendations. We choose not to implement these recommendations at this time, however.

III. FURTHER NOTICE OF PROPOSED RULEMAKING

38. In enacting the Act, Congress sought to introduce competition into local telephone service, which traditionally was provided through regulated monopolies. Recognizing that in introducing such competition, it was threatening the implicit subsidy system that had traditionally supported universal service, it directed the Commission to reform its universal service program to make support

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[130] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions NPRM*); *Joint Board Comprehensive Reform NPRM*, 23 FCC Rcd 1531 (collectively the *High-Cost Reform NPRMs*).

[131] 47 U.S.C. § 254(a)(2).

explicit and sustainable in the face of developing competition.

39. The communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted. The Internet was only briefly mentioned in the 1996 Act,[132] but now has come into widespread use, with broadband Internet access service increasingly viewed as a necessity. Consistent with this trend, carriers are converting from circuit-switched networks to IP-based networks. These changes have benefited consumers and should be encouraged. Competition has resulted in dramatically lower prices for telephone service, and the introduction of innovative broadband products and services has fundamentally changed the way we communicate, work, and obtain our education, news, and entertainment. At the same time, however, these developments have challenged the outdated regulatory assumptions underlying our universal service and intercarrier compensation regimes, forcing us to reassess our existing approaches. We have seen unprecedented growth in the universal service fund, driven in significant part by increased support for competitive ETCs. The growth of competition also has eroded the universal service contribution base as the prices for interstate and international services have dropped. Finally, we have seen numerous competitors exploit arbitrage opportunities created by a patchwork of above-cost intercarrier compensation rates.

40. We seek comment today on three specific proposals. The first, attached as Appendix A, is the Chairman's Draft Proposal circulated to the Commission on October 15, 2008, which was placed on the Commission's

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[132] *See* 47 U.S.C. § 230; 47 U.S.C. § 157 nt.

agenda for a vote on November 4, 2008. This item subsequently was removed from the Agenda on November 3, 2008.[133] The second, attached as Appendix B, is a Narrow Universal Service Reform Proposal circulated to the Commission on October 31, 2008. The third, attached as Appendix C, is a draft Alternative Proposal first circulated by the Chairman on the evening of November 5, 2008. Appendix C incorporates changes proposed in the *ex parte* presentations attached as Appendix D. We note that members of industry, Congress, and the general public have urged the Commission to seek comment on these proposals.

41. We seek particular comment on two questions. First, should the additional cost standard utilized under § 252(d)(2) of the Act be: (i) the existing TELRIC standard; or (ii) the incremental cost standard described in the draft order? Second, should the terminating rate for all § 251(b)(5) traffic be set as: (i) a single, statewide rate; or (ii) a single rate per operating company?

IV. PROCEDURAL MATTERS

A. *Ex Parte* Presentations

42. The rulemaking this Further Notice initiates shall be treated as a "permit-but-disclose" proceeding in accordance with the Commission's *ex parte* rules.[134] Persons making oral *ex parte* presentations are reminded that memoranda summarizing the presentations must contain summaries of the substance of the presentations and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and argu-

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[133] *See* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-286532A1.pdf.

[134] 47 C.F.R. § 1.200 *et seq.*

ments presented generally is required.[135] Other requirements pertaining to oral and written presentations are set forth in section 1.1206(b) of the Commission's rules.[136]

B. Comment Filing Procedures

43. Pursuant to sections 1.415 and 1.419 of the Commission's rules,[137] interested parties may file comments and reply comments regarding the Further Notice on or before the dates indicated on the first page of this document. **All filings should refer to CC Docket Nos. 96-45, 96-98, 99-68, 99-200, 01-92 and WC Docket Nos. 03-109, 04-36, 05-337, and 06-122.** Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS); (2) the Federal Government's e-Rulemaking Portal, or; (3) by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 FR 24121 (1998).

44. Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal e-Rulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

45. ECFS filers must transmit one electronic copy of the comments for CC Docket Nos. 96-45, 96-98, 99-68, 99-200, 01-92 and WC Docket Nos. 03-109, 04-36, 05-337, and 06-122, respectively. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should

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[135] *See* 47 C.F.R. § 1.1206(b)(2).

[136] 47 C.F.R. § 1.1206(b).

[137] 47 C.F.R. §§ 1.415, 1.419.

send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

46. Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554.

47. The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

48. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

49. U.S. Postal Service first-class, Express, and Priority mail should be addressed to 445 12th Street, S.W., Washington D.C. 20554. Parties should send a copy of their filings to Victoria Goldberg, Pricing Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A266, 445 12th Street, S.W., Washington, D.C. 20554, and to Jennifer McKee, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission,

Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

50. Documents in CC Docket Nos. 96-45, 96-98, 99-68, 99-200, 01-92 and WC Docket Nos. 03-109, 04-36, 05-337, and 06-122 will be available for public inspection and copying during business hours at the FCC Reference Information Center, Portals II, 445 12th Street S.W., Room CY-A257, Washington, D.C. 20554. The documents may also be purchased from BCPI, telephone (202) 488-5300, facsimile (202) 488-5563, TTY (202) 488-5562, e-mail fcc@bcpiweb.com.

C. Initial Regulatory Flexibility Analysis

51. As required by the Regulatory Flexibility Act of 1980,[138] the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the policies and rules addressed in this document. The IRFA is set forth as Appendix E. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice provided on or before the dates indicated on the first page of this Notice.

D. Paperwork Reduction Act

52. This document contains proposed new or modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information

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[138] *See* 5 U.S.C. § 603.

collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198,[139] we seek specific comment on how we might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

E. Accessible Formats

53. To request materials in accessible formats for people with disabilities (Braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice) or 202-418-0432 (TTY). Contact the FCC to request reasonable accommodations for filing comments (accessible format documents, sign language interpreters, CART, etc.) by e-mail: FCC504@fcc.gov; phone: 202-418-0530 or TTY: 202-418-0432.

F. Congressional Review Act

54. The Commission will include a copy of this **ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING** in a report to be sent to Congress and the Government Accountability Office pursuant to the Congressional Review Act. *See* 5 U.S.C. § 801(a)(1)(A).

V. ORDERING CLAUSES

55. Accordingly, IT IS ORDERED that, pursuant to Sections 1-4, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, and 503 of the Communications Act of 1934, as amended, and Sections 601 and 706 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 157 nt, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r),

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[139] *See* 44 U.S.C. § 3506(c)(4).

332, 403, 502, 503, and sections 1.1, 1.411-1.429, and 1.1200-1.1216 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.411-1.429, 1.1200-1.1216, the ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING ARE ADOPTED.

56. IT IS FURTHER ORDERED, in light of the opinion of the United States Court of Appeals for the District of Columbia Circuit in *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), we consider our obligations met from the writ of mandamus issued in *In re Core Communications, Inc. on Petition for Writ of Mandamus to the Federal Communications Commission*, D.C. Cir. No. 07-1446 (decided July 8, 2008).

57. IT IS FURTHER ORDERED that this FURTHER NOTICE OF PROPOSED RULEMAKING SHALL BECOME EFFECTIVE on the date of publication of the text of a summary thereof in the Federal Register, pursuant to 47 C.F.R. §§ 1.4, 1.13.

58. IT IS FURTHER ORDERED that this ORDER ON REMAND AND REPORT AND ORDER SHALL BE EFFECTIVE upon release.

59. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL
COMMUNICATIONS
COMMISSION

Marlene H. Dortch
Secretary

FEDERAL COMMUNICATIONS COMMISSION
FCC 08-262

APPENDIX A
Chairman's Draft Proposal

In the Matter of

High-Cost Universal Service Support
WC Docket No. 05-337

Federal-State Joint Board
on Universal Service
CC Docket No. 96-45

Lifeline and Link Up
WC Docket No. 03-109

Universal Service Contribution Methodology
WC Docket No. 06-122

Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC Docket No. 96-98

Developing a Unified Intercarrier
Compensation Regime
CC Docket No. 01-92

Intercarrier Compensation
for ISP-Bound Traffic
CC Docket No. 99-68

IP-ENABLED SERVICES
WC DOCKET NO. 04-36

NUMBERING RESOURCE OPTIMIZATION
CC DOCKET NO. 99-200

ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: "Insert Adopted Date"
Released: "Insert Release Date"

Comment Date:	**[XX days after publication in the Federal Register]**
Reply Comment Date:	**[XX days after publication in the Federal Register]**

TABLE OF CONTENTS

Heading — Paragraph #

I. INTRODUCTION 1
II. REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT 4
A. Background 5
B. Discussion 12
1. Controlling the Growth of the High-Cost Fund 14
2. Conditioning Support on Offering Broadband Internet Access Service 19
a. Definition of Broadband Internet Access Service 24
b. Broadband Internet Access Service Obligations 25
3. Incumbent LECs' Commitment to Offer Broadband 28
4. Reverse Auctions for Study Areas Unserved by Broadband 32
a. Geographic Area 35
b. Reserve Price 36
c. Auctioned Support 38
d. Selecting a Winning Bid 43
e. Bidder Qualifications 48
5. Competitive Eligible Telecommunications Carriers 51
a. Background 51
b. Certification by Existing Competitive ETCs 52
c. Calculation of Support 53

6. Build-Out Milestones and Monitoring, Compliance, and Enforcement 57
III. BROADBAND FOR LIFELINE/LINK UP CUSTOMERS 64
A. Background 65
B. Discussion 71
1. Available Funding 77
2. Eligible Services and Equipment 80
3. Selection Criteria 85
4. Implementation and Reporting Requirements 88
5. Program Oversight 91
IV. REFORM OF UNIVERSAL SERVICE CONTRIBUTIONS 92
A. Background 93
B. Discussion 97
1. Legal Authority 98
2. The New Numbers-Based Assessment Methodology for Residential Services 105
a. Benefits of a Numbers-Based Contribution Methodology 106
b. Assessable Numbers 115
3. Contribution Assessment Methodology for Business Services 130
4. Wireless Prepaid Plans 135
5. Exceptions to Contribution Obligations 140
6. Reporting Requirements and Recordkeeping 147
7. Transition to New Methodology 154

V. REFORM OF INTERCARRIER COMPENSATION 157
A. A Brief History of Intercarrier Compensation 159
1. Intercarrier Compensation Regulation Before the Telecommunications Act of 1996 160
2. Intercarrier Compensation Regulation Since the 1996 Act 169
3. Problems Associated With the Existing Intercarrier Compensation Regimes 178
B. Comprehensive Reform 186
1. Introduction 186
2. A New Approach to Intercarrier Compensation 188
3. Legal Authority 207
a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g) 207
b. Legal Authority for the Transition 230
4. Additional Costs Standard 236
a. Background 237
b. The Importance of Incremental Cost in Regulated Pricing 240
c. The Incremental Cost of Call Termination on Modern Networks 253
d. Reconsideration of Additional Costs Standard 262
C. Implementation 269
1. Direction to the States 270

a. Setting Final Reciprocal Compensation Rates Based on Incremental Cost 271
b. Symmetry 276
c. Modifications and Suspensions under Section 251(f)(2) 282
d. Existing Agreements 291
2. Revenue-Recovery Opportunities 294
a. End-User Charges 296
b. Universal Service Support 311
D. Measures to Ensure Proper Billing 326
1. Introduction 326
2. Background 327
3. Discussion 329
a. Signaling Information 330
b. Financial Responsibilities 336
VI. FURTHER NOTICE OF PROPOSED RULEMAKING 343
A. Universal Service Contributions 343
B. Intercarrier Compensation Further Notice 345
VII. PROCEDURAL MATTERS 350
A. *Ex Parte* Presentations 350
B. Comment Filing Procedures 351
C. Initial Regulatory Flexibility Analysis 362
D. Final Regulatory Flexibility Analysis 363
E. Paperwork Reduction Act 364
F. Accessible Formats 365
G. Congressional Review Act 366
VIII. ORDERING CLAUSES 367

I. INTRODUCTION

1. In enacting the Telecommunications Act of 1996 (1996 Act),[1] Congress sought to introduce competition into local telephone service, which traditionally was provided through regulated monopolies. Recognizing that in introducing such competition, it was threatening the implicit subsidy system that had traditionally supported universal service, it directed the Commission to reform its universal service program to make support explicit and sustainable in the face of developing competition.

2. For the most part, Congress's vision has been realized. Competition in local telephone markets has thrived. At the same time, the communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted. The Internet was only briefly mentioned in the 1996 Act,[2] but now has come into widespread use, with broadband Internet access service increasingly viewed as a necessity. Consistent with this trend, carriers are converting from circuit-switched networks to Internet Protocol (IP)-based networks. These changes have benefited consumers and should be encouraged. Competition has resulted in dramatically lower prices for telephone service, and the introduction of innovative broadband products and services has fundamentally changed the way we communicate, work, and obtain our education, news, and entertainment. At the same time, however, these developments have challenged the outdated regulatory assumptions underlying our universal service and intercarrier compensation regimes, forcing us to reassess our existing approaches.

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act).

[2] *See* 47 U.S.C. § 230; 47 U.S.C. § 157 nt.

We have seen unprecedented growth in the universal service fund, driven in significant part by increased support for competitive eligible telecommunications carriers (ETCs). The growth of competition also has eroded the universal service contribution base as the prices for interstate and international services have dropped. Finally, we have seen numerous competitors exploit arbitrage opportunities created by a patchwork of above-cost intercarrier compensation rates. Although the Commission has attempted to address many of these issues on a case-by-case basis, it has become increasingly clear that piecemeal efforts to respond to these developments are inadequate—only comprehensive reform can address the fundamental challenges that they present.[3]

3. Today we adopt a comprehensive approach to addressing these difficult, but critical issues. First, we spur widespread deployment of broadband by ensuring that carriers receiving universal service high-cost support of-

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[3] We thus conclude that there is a compelling need to proceed with comprehensive reform at this time, as we describe below. *See, e.g., infra* Parts II.A, III.A, IV.A, and V.B. Given that we have notice and an extensive record, going back in some cases seven years, we are unpersuaded by commenters proposing that we delay reform to seek further comment, or that we issue a Further Notice of Proposed Rulemaking on questions beyond those raised in Part VI. *See e.g.*, Letter from Ray Baum, Chairman, NARUC Communications Committee, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 80-286, WC Docket Nos. 08-152, 04-32, 06-122, WT Docket No. 05-194 at 2 (filed Oct. 21, 2008) (NARUC Oct. 21, 2008 *Ex Parte* Letter); Letter from Jeffery S. Lanning, Embarq, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 04-36 at 2 (filed Oct. 28, 2008) (Embarq Oct. 28, 2008 *Ex Parte* Letter); Letter from Eric N. Einhorn, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 06-122, 07-135, 08-152 at 1 (filed October 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter).

fer broadband throughout their service areas. Second, we help Lifeline/Link Up customers participate in this new broadband world by creating a pilot program to provide discounted access to broadband services. Third, we broaden and stabilize our universal service contribution base through equitable and non-discriminatory contributions. Fourth, having placed our universal service fund on solid footing, we now take the long-overdue step of moving toward uniform intercarrier compensation rates that provide efficient incentives for the investment in and use of broadband networks. Finally, our approach minimizes disruptions to carriers and safeguards universal service for consumers by adopting sensible transition plans and ensuring that universal service is used to support service in high-cost areas, not carriers' dividends.

II. REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT

4. Today we take a monumental step toward our goal of ensuring that broadband is available to all Americans. We do this by requiring that all recipients of high-cost support offer broadband Internet access service to all customers within their supported areas as a condition of receiving future support. Taking this action will promote the deployment of broadband Internet access service to all areas of the nation, including high-cost, rural, and insular areas where customers may not currently have access to such services. In particular, as a condition of receiving continued high-cost support, we will require all incumbent local exchange carriers (LECs) to commit to offer broadband Internet access service within five years to all customers in study areas where the incumbent LECs receive high-cost support. Competitive eligible telecommunications carriers (ETCs) likewise will be required to commit to offer broadband Internet access ser-

vices to all customers in their service areas within five years to continue to receive high-cost support, which will be distributed based on the competitive ETCs' own costs. Competitive ETCs that do not make this commitment will not be eligible to receive high-cost support; incumbent LECs that do not make this commitment will gradually lose their high-cost support, as this support will be awarded via reverse auction to an ETC who will meet carrier of last resort obligations and will commit to offering broadband Internet access to all customers in the entire study area within ten years. With these reforms, we take great strides toward ensuring that all Americans, regardless of where they live, will have broadband Internet access service available to them, without increasing the size of the high-cost fund.

A. Background

5. The 1996 Act amended the Communications Act of 1934 (the Act) with respect to the provision of universal service.[4] Congress sought to preserve and advance universal service, while at the same time opening all telecommunications markets to competition.[5] Section 254(b) of the Act directs the Federal-State Joint Board on Universal Service (Joint Board) and the Commission to base policies for the preservation and advancement of universal service on several general principles, plus other principles that the Commission may establish.[6] Among other things, section 254(b) directs that there should be specific, predictable, and sufficient federal and state universal service support mechanisms; quality services should be available at just, reasonable, and affordable rates; and

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[4] 47 U.S.C. § 254 (added by the 1996 Act).

[5] 47 U.S.C. § 254.

[6] *See* 47 U.S.C. § 254(b).

access to advanced telecommunications and information services should be provided in all regions of the nation.[7]

6. The Commission implemented the universal service provisions of the 1996 Act in the 1997 *Universal Service First Report and Order*.[8] In considering methods to determine universal service support in rural, insular, and high-cost areas, the Commission examined the use of competitive bidding, and identified several advantages of competitive bidding as a method for allocating high-cost universal service support.[9] First, the Commission found that "a compelling reason to use competitive bidding is its potential as a market-based approach to determining universal service support, if any, for any given area."[10] Second, "by encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured competitive bidding system would be its ability to reduce the amount of support needed for universal service."[11] Despite these advantages, the Commission determined that the record at the

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[7] 47 U.S.C. § 254(b)(1), (2), (5).

[8] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8780-88, paras. 1-20 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

[9] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[10] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 (agreeing with the Joint Board). The Commission also agreed with the Joint Board that "competitive bidding is consistent with section 254, and comports with the intent of the 1996 Act to rely on market forces and to minimize regulation." *Id.* at 8951, para. 325

[11] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 ("In that regard, the bidding process should also capture the efficiency gains from new technologies or improved productivity, converting them into cost savings for universal service.").

time was insufficient to support adoption of a competitive bidding mechanism.[12] Moreover, the Commission found it unlikely that competitive bidding mechanisms would be useful at that time because there likely would be no competition in a significant number of rural, insular, or high-cost areas in the near future.[13] The Commission, therefore, declined to adopt a competitive bidding mechanism at that time, but found that competitive bidding warranted further consideration as a potential mechanism for determining levels of high-cost support in the future.[14]

7. Pursuant to section 254(e) of the Act, an entity must be designated as an eligible telecommunications carrier (ETC) to receive high-cost universal service support.[15] ETCs may be incumbent LECs, or non-incumbent LECs, which are referred to as "competitive ETCs."[16] Under the existing high-cost support distribution mechanism, incumbent LEC ETCs receive high-cost support

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[12] *See Universal Service First Report and Order*, 12 FCC Rcd at 8949-50, paras. 322 23. Only GTE had proposed a detailed competitive bidding plan, which it characterized as an outline rather than a final proposal. *See* GTE's Comments in Response to Questions, CC Docket No. 96-45, Attach. 1 (filed Aug. 2, 1996).

[13] *See Universal Service First Report and Order*, 12 FCC Rcd at 8950, para. 324.

[14] *See Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[15] 47 U.S.C. § 254(e). The statutory requirements for ETC designation are set out in section 214(e) of the Communications Act of 1934, as amended (Communications Act or Act). 47 U.S.C. § 214(e).

[16] *See* 47 C.F.R. § 54.5 ("A 'competitive eligible telecommunications carrier' is a carrier that meets the definition of 'eligible telecommunications carrier' below and does not meet the definition of an 'incumbent local exchange carrier' in § 51.5 of this chapter.").

for their intrastate services based on their costs.[17] Competitive ETCs, on the other hand, receive support for each of their lines based on the per-line support the incumbent LEC receives in the service area.[18] This support to competitive ETCs is known as "identical support." The Commission's universal service high-cost support rules do not distinguish between primary and secondary lines; therefore, high-cost support may go to a single end user for multiple connections.[19] Further, the Commission's rules may result in multiple competitors in the same high-cost area receiving identical per-line support.

8. High-cost support for competitive ETCs has grown rapidly over the last several years, which has placed extraordinary pressure on the federal universal service fund.[20] In 2001, high-cost universal service support to-

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[17] Non-rural incumbent LEC ETCs receive support for their intrastate supported services based on the forward-looking economic cost of providing the services. 47 C.F.R. § 54.309. Rural incumbent LEC ETCs receive support based on their loop costs, as compared to a national average. 47 C.F.R. Part 36, sbpt. F; 47 C.F.R. § 54.305. Incumbent LEC ETCs that serve study areas with 50,000 or fewer lines receive support based on their local switching costs. 47 C.F.R. § 54.301. Additionally, incumbent LEC ETCs that are subject to price cap or rate-of-return regulation receive interstate access support based on their revenue requirements. 47 C.F.R. Part 54, sbpts. J, K.

[18] 47 C.F.R. § 54.307(a).

[19] *See Universal Service First Report and Order*, 12 FCC Rcd at 8828-30, paras. 94-96.

[20] Support for the fund derives from assessments paid by providers of interstate telecommunications services and certain other providers of interstate telecommunications. *See* 47 C.F.R. § 54.706. Fund contributors are permitted to, and almost always do, pass those assessments th[r]ough to their end-user customers. *See* 47 C.F.R. § 54.712. Fund assessments paid by contributors are determined by applying the quarterly contribution factor to the contributors' contribution base revenues. In the second quarter of 2007, the contribu-

taled approximately $2.6 billion.[21] By 2007, the amount of high-cost support had grown to approximately $4.3 billion per year.[22] In recent years, this growth has been due mostly to increased support provided to competitive ETCs, which pursuant to the identical support rule receive high-cost support based on the incumbent LEC's per-line support. Competitive ETC support, in the six years from 2001 through 2007, has grown from under $17 million to $1.18 billion—an annual growth rate of over 100 percent.[23] This "funded competition" has grown significantly in a large number of rural, insular, or high cost areas; in some study areas, more than 20 competitive ETCs currently receive support.[24]

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tion factor reached 11.7%, which is the highest level since its inception. *See Proposed Second Quarter 2007 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 22 FCC Rcd 5074, 5077 (OMD 2007). The contribution factor has since declined to 11.4% in the fourth quarter of 2008. *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD 2008).

[21] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 3.2 (2007) (2007 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-279226A1.pdf.

[22] UNIVERSAL SERVICE ADMINISTRATIVE COMPANY, 2007 ANNUAL REPORT 43 (2007) (USAC 2007 ANNUAL REPORT), *available at* http://www.usac.org/_res/documents/about/pdf/usacannual-report-2007.pdf.

[23] 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 3.2; USAC 2007 ANNUAL REPORT at 45.

[24] *See* USAC Quarterly Administrative Filings for 2008, Fourth Quarter (4Q) Appendices, HC03—Rural Study Areas with Competition—4Q2008, *available at* http://www.usac.org/about/governance/fcc-filings/2008/Q4/HC03%20%20?Rural%20Study%20Areas%20with%20Competition%20-%204Q2008.xls (showing 24 competitive ETCs in the study area of incumbent LEC Iowa Telecom North (study area

9. To address the growth in competitive ETC support, the Joint Board recommended an interim cap on the amount of high-cost support available to competitive ETCs, pending comprehensive high-cost universal service reform. The Commission adopted this recommendation in 2008.[25]

10. For the past several years, the Joint Board and the Commission have been exploring ways to reform the Commission's high-cost program. In the most recent high-cost support comprehensive reform efforts, the Joint Board issued a recommended decision on November 20, 2007.[26] The Joint Board recommended that the Commission address reforms to the high-cost program and make "fundamental revisions in the structure of existing Universal Service mechanisms."[27] Specifically, the

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code 351167), and 22 competitive ETCs in the study area of incumbent LEC Iowa Telecom Systems (study area code 351170).

[25] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 8998, 8999-9001, paras. 4-7 (JB 2007) (*Interim Cap Recommended Decision*); *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (2008) (*Interim Cap Order*). As recommended by the Joint Board, the Commission capped competitive ETC support for each state. *Interim Cap Recommended Decision*, 22 FCC Rcd at 9002, para. 9; *Interim Cap Order*, 23 FCC Rcd at 8846, paras. 26-28. The Commission set the cap at the level of support competitive ETCs were eligible to receive during March 2008. *Interim Cap Order*, 23 FCC Rcd at 8850, para. 38.

[26] *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (JB 2007) (*Comprehensive Reform Recommended Decision*).

[27] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 1.

Joint Board recommended that the Commission should: (1) deliver high-cost support through a provider of last resort fund, a mobility fund, and a broadband fund;[28] (2) cap the high-cost fund at $4.5 billion, the approximate level of 2007 high-cost support;[29] (3) reduce the existing funding mechanisms during a transition period;[30] (4) add broadband and mobility to the list of services eligible for support under section 254 of the Act;[31] (5) eliminate the identical support rule;[32] and (6) "explore the most appropriate auction mechanisms to determine high-cost universal service support."[33]

11. On January 29, 2008, the Commission released three notices of proposed rulemaking addressing proposals for comprehensive reform of high-cost universal service support.[34] In the *Identical Support NPRM*, the

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[28] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20480-81, para. 11.

[29] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26.

[30] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 27.

[31] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481-82, paras. 12-18.

[32] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20486, para. 35.

[33] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, paras. 1-6.

[34] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rule-

Commission sought comment on the Commission's rules governing the amount of high-cost universal service support provided to competitive ETCs.[35] It tentatively concluded that the Commission should eliminate the identical support rule.[36] The Commission also tentatively concluded that support to a competitive ETC should be based on the competitive ETC's own costs of providing the supported services, and it sought comment on how the support should be calculated, the reporting obligations to be applied, and whether the Commission should cap such support at the level of the incumbent LEC's support.[37] In the *Reverse Auctions NPRM*, the Commission tentatively concluded that reverse auctions offer several potential advantages over current high-cost mechanisms and sought comment on whether they should be used as the disbursement mechanism to determine the amount of high-cost universal service support for ETCs serving rural, insular, and high-cost areas, and it sought comment on how to implement reverse auctions for this purpose.[38] The Commission also sought comment on a number of specific issues regarding auctions and auction design.[39] The Commission also released the *Joint Board Comprehensive Reform NPRM*, seeking comment on the Joint Board's *Comprehensive Reform Recommended Decision* and incorporating by reference the *Identical Support NPRM* and the *Reverse Auctions*

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making, 23 FCC Rcd 1531 (2008) (*Joint Board Comprehensive Reform NPRM*) (collectively the *High-Cost Reform NPRMs*).

[35] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

[36] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

[37] *Identical Support NPRM*, 23 FCC Rcd at 1473-78, paras. 12-25.

[38] *Reverse Auctions NPRM*, 23 FCC Rcd at 1495, para. 1.

[39] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500-12, paras. 10-50.

NPRM.[40] The discussion that follows represents our response to the Joint Board's *Comprehensive Reform Recommended Decision*, pursuant to section 254(a)(2).[41]

B. Discussion

12. Today we comprehensively reform the high-cost universal service support mechanism, and take steps to ensure that broadband Internet access service is deployed quickly to all areas of the country, including rural and insular areas. The steps we take today will provide certainty to providers as to the levels of support available to them in providing supported services and broadband Internet access service to all customers within the supported areas. This will assist providers in creating business plans to deploy services in currently unserved areas and will ensure efficiency in the deployment of services to these areas. Specifically, we are defining the level of high-cost support available to providers that commit to offer broadband to all customers within a service area. Support in incumbent LEC service areas will be set at the total amount of high-cost support disbursed to the incumbent LEC ETC in December 2008 on an annualized basis. Incumbent LEC ETCs will continue to receive this level of support if they commit to offer broadband Internet access services to all customers within the service area within five years. If an incumbent LEC does not make this broadband commitment for a particular service area, the support will be transitioned to the win-

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[40] *Joint Board Comprehensive Reform NPRM*, 23 FCC Rcd at 1531, para. 1.

[41] 47 U.S.C. § 254(a)(2). Pursuant to that section, the Commission shall complete any proceeding to implement a Joint Board recommendation within one year after receiving it. The Commission has acted on the *Comprehensive Reform Recommended Decision* prior to the November 20, 2008 one-year statutory deadline.

ning bidder of a reverse auction that will commit to deploy broadband throughout the service area within ten years, and to take on carrier of last resort obligations. Competitive ETCs will receive high-cost support, based on their own costs as compared to the relevant high-cost support thresholds, so long as they, too, commit to offer broadband Internet access service to all customers in their service areas within five years. While ensuring that broadband Internet access service is made available to customers in rural and high-cost areas, we also cap the overall size of the high-cost mechanism to protect customers in all areas of the nation from increasing universal service contribution assessments.

13. The requirements that we adopt for disbursement of high-cost universal service support do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions.[42] We find that these areas have very different attributes and related cost issues than do the continental states.[43] For this reason, we are exempt-

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[42] Providers operating in U.S. Territories and possessions, such as Puerto Rico and Guam, are not subject to the high-cost support requirements adopted in this order. *See* Letter from Earl Comstock, Comstock Consulting LLC, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-377 at 1 (dated Oct. 15, 2008) (asking the Commission to recognize the higher costs and lower income levels in Puerto Rico in any reform efforts it may take); Letter from Eric N. Votaw, Vice President—Marketing & Regulatory, GTA Telecom, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-45, WC Docket No. 05-337 at 1-2 (filed Oct. 24, 2008) (asking the Commission to recognize that Guam's costs are higher than the continental United States and that Guam should be treated separately, along with Alaska and Hawaii, for reform purposes).

[43] *E.g., Verizon Commc'ns, Inc., Transferor, and América Móvil, S.A. de C.V., Transferee*, WT Docket No. 06-113, Memorandum Opinion and Order and Declaratory Ruling, 22 FCC Rcd 6195, 6211, para. 36 (2007) (*Verizon/América Móvil Transfer Order*) (describing

ing providers in Alaska, Hawaii and U.S. Territories or possessions from the high-cost support requirements and rules adopted herein, and we will address them in a subsequent proceeding.[44]

1. Controlling the Growth of the High-Cost Fund

14. Consistent with the recommendation of the Joint Board, we cap the total amount of high-cost universal service support.[45] As the Joint Board recognized, high-cost support currently accounts for more than half of to-

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"difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Integration of Rates and Services for Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands*, CC Docket No. 83-1376, Supplemental Order Inviting Comments, 4 FCC Rcd 395, 396, paras. 7-8 (1989) (*Rates and Services Integration Order*) (describing the unique market conditions and structure in Alaska); Letter from Brita D. Strandberg, Counsel for General Communication, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 05-337 at 2 (Oct. 3, 2008) (discussing Alaska's particular service needs and network architecture).

[44] *Cf. The Establishment of Policies and Service Rules for the Broadcasting-Satellite Service at the 17.3-17.7 GHz Frequency Band and at the 17.7-17.8 GHz Frequency Band Internationally, and at the 24.75-25.25 GHz Frequency Band for Fixed Satellite Services Providing Feeder Links to the Broadcasting-Satellite Service and for the Satellite Services Operating Bi-directionally in the 17.3-17.8 GHz Frequency Band*, IB Docket No. 06 123, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 8842, 8860, para. 47 (2007) (*Policies and Service Rules for the Broadcasting-Satellite Service Order*) ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[45] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, 20481, 20484, paras. 2, 11, 26.

tal federal universal service support.[46] Since 1997, when the Commission implemented the universal service requirements of section 254 of the Act, high-cost support has increased by 240 percent.[47] Although, earlier this year, we took an initial step to address high-cost fund growth by capping support to competitive ETCs, that cap was an interim, emergency measure, pending a closer examination of the steps necessary to achieve comprehensive reform.[48] Many commenters have urged the Commission to cap the overall amount of high-cost support, rather than limiting the cap only to competitive ETCs.[49]

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[46] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26. In 2007, total federal universal service disbursements amounted to approximately $6.95 billion. Of that amount, approximately $4.29 billion, 62%, was disbursed as high-cost support. USAC 2007 ANNUAL REPORT at 51.

[47] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at 3-14, tbl. 3.1 (high-cost support in 1997 was approximately $1.26 billion, compared with approximately $4.29 billion in 2007). Even taking into account the fact that additional interstate support mechanisms, Interstate Access Support (IAS) and Interstate Common Line Support (ICLS), were created in 2000 and 2001, respectively, high-cost support has still increased by more than 45%, from approximately $2.94 billion in 2002 to its current level of approximately $4.29 billion. *Id.*

[48] *See Interim Cap Order*, 23 FCC Rcd at 8834, para. 1.

[49] *See* CenturyTel *High-Cost Reform NPRMs* Comments at 18 (existing high-cost support mechanisms should be frozen at the study area level or on a statewide basis to provide funding certainty and encourage investment); Chinook *High-Cost Reform NPRMs* Comments, Attach. at 5-6 (any cap on universal service support should apply to all ETCs, including incumbent LECs); Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 5 (supporting a cap on high-cost support set at the 2007 level); Florida PSC *High-Cost Reform NPRMs* Comments at 2 (supporting the recommendation to cap the overall size of the high-cost fund); Information Technology Industry Council (ITI) *High-Cost Reform NPRMs* Comments at 7 (an overall cap should be applied to control the size of the high-cost mechanism); NCTA *High-Cost Reform NPRMs* Com-

Although other commenters oppose the adoption of a cap on the total amount of high-cost support or on the amount of support available to incumbent LEC ETCs,[50] we find that, to manage the high-cost support mechanism effectively, we must control its growth, and that capping support in the manner discussed below will provide specific, predictable, and sufficient support to preserve and advance universal service.[51]

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ments at 19 (the Joint Board's proposal to cap the overall size of the high-cost mechanism is "a welcome dose of fiscal responsibility"); National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2-3 (supporting the Joint Board's proposal to cap the overall high-cost fund); Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 2-3, 6-9 (Commission should cap the overall high-cost fund).

[50] *See* Frontier *High-Cost Reform NPRMs* Comments at 6-7; JSI *High-Cost Reform NPRMs* Comments at 6; Montana Telecommunications Ass'n *High-Cost Reform NPRMs* Comments at 21-22; NECA *High-Cost Reform NPRMs* Comments at 17-20; TCA *High-Cost Reform NPRMs* Comments at 10-11; TDS *High-Cost Reform NPRMs* Comments at 8-9; Missouri Small Telephone Company Group (MSTC) *High-Cost Reform NPRMs* Reply at 5-7; Utah Rural Telecom Ass'n *High-Cost Reform NPRMs* Reply at 5.

[51] 47 U.S.C. § 254(b)(5); *see* CenturyTel *High-Cost Reform NPRMs* Comments at 18; Comcast *High-Cost Reform NPRMs* Comments at 3, 11; Florida PSC *High-Cost Reform NPRMs* Comments at 8-9; National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2; NCTA *High-Cost Reform NPRMs* Comments at 4-6; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Comments at 52-54; Oregon PUC *High-Cost Reform NPRMs* Comments at 2-3; Sprint Nextel *High-Cost Reform NPRMs* Comments at 3; USTelecom *High-Cost Reform NPRMs* Comments at 2; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 7; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Reply at 64-65; Sprint Nextel *High-Cost Reform NPRMs* Reply at 8-9; State Commissioners *High-Cost Reform NPRMs* Reply at 2; Texas Office of Public Utility Counsel *Joint Board Comprehensive Reform NPRM* Reply at 2; Virgin Mobile

15. We find it necessary to cap the high-cost mechanism as a first step toward fulfilling our statutory obligation to create specific, predictable and sufficient universal service support mechanisms.[52] As the United States Court of Appeals for the Fifth Circuit held in *Alenco*: "[t]he agency's broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service."[53] The *Alenco* court also found that "excessive funding may itself violate the sufficiency requirements,"[54] and the United States Court of Appeals for the Tenth Circuit has stated that "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in [section] 254(b)(1)."[55] Given the excessive growth in high-cost support, we find it necessary to cap this mechanism to ensure that unsubsidized users who contribute to the fund are not harmed by excessive subsidization.

High-Cost Reform NPRMs Reply at 3-4. The Commission has already implemented caps on the schools and libraries and rural health care universal service mechanisms. *Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704 (establishing a $2.25 billion annual cap for the schools and libraries mechanism and a $400 million annual cap for the rural health care mechanism); *see also* 47 C.F.R. §§ 54.507(a), 54.623(a).

[52] 47 U.S.C. § 254(b)(5); *see also Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704.

[53] *Alenco Commc'ns, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000) (*Alenco*).

[54] *Alenco*, 201 F.3d at 620.

[55] *Qwest Commc'ns Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

16. Therefore, we take several steps to limit the growth of high-cost support. First, we cap the overall high-cost fund at the total amount of high-cost support disbursed by the Universal Service Administrative Company (USAC) for December 2008 on an annualized basis, net of any prior or past period adjustments. Although we agree with the Joint Board's recommendation to cap the high-cost mechanism, rather than set such a cap at the 2007 level of high-cost support as the Joint Board recommended, we find it is more appropriate to set the cap at the level of support disbursed by USAC in December 2008 on an annualized basis. Furthermore, we freeze each incumbent LEC ETC's individual, annual high-cost support at the amount of support, on a lump sum basis, that the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[56]

17. As discussed below, we also eliminate the identical support rule for competitive ETCs. Competitive ETCs' support levels will be based on their costs as compared to the relevant high-cost support mechanism benchmarks, and frozen at the amount of support, on a

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[56] Pursuant to section 214(e)(5) of the Act, the term "service area" is used to refer to the geographic area established by a state commission or this Commission for the purpose of determining universal service obligations and support mechanisms. 47 U.S.C. § 214(e)(5). For a rural telephone company, section 214(e)(5) states that "service area" shall mean the rural company's "study area" unless and until the Commission and the states establish a different definition of service area for such company. *Id.* In this order, we use the terms "service area" and "study area" interchangeably. Nothing in this order is meant to change any redefinitions of service area previously established by the Commission and/or the state commissions.

lump sum basis, that the competitive ETC received in 2008 on a study area basis.[57]

18. Consistent with section 254(b)(5) of the Act, we find that capping high-cost support in this manner will enable ETCs to predict the specific level of support that they will receive should they choose to participate in the program.[58] To the extent that an incumbent LEC ETC determines that it cannot offer broadband Internet access service throughout its service area at the specified level of support, as discussed below, that particular study area will be deemed an "Unserved Study Area," and we will conduct a reverse auction to determine the entity capable of meeting our service requirements and the amount of support to provide for that area. In fact, through the reverse auction process, it will be the bidders, not the Commission, that determine how much support they would need to offer service. Finally, as discussed below, if the reverse auction process does not yield a winning bidder, the Commission will reexamine whether it needs to take further action with regard to this situation, should it arise.

2. Conditioning Support on Offering Broadband Internet Access Service

19. The broadband era is here. Those of us who have broadband Internet access service use it to communicate, to work, to get vital information, to be educated, and to be entertained. Broadband Internet access service—a novelty at the time of the passage of the 1996 Act—is now mainstream. Yet some Americans still lack access to this vital service, and as Commissioner Copps has said, "does America at the beginning of the 21st century be-

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[57] *See infra* paras. 53-56.

[58] 47 U.S.C. § 254(b)(5).

come technologically stagnant or the leader of the Digital Age? For me, the answer to that question depends in some significant measure upon whether we succeed in bringing high-speed, high-value broadband and an open Internet to all Americans . . . rural as well as urban folks . . . ."[59]

20. Today, we modify our high-cost support system fundamentally to spur deployment and ensure that all Americans have access to broadband. Specifically, we make offering broadband Internet access service a condition of being eligible to receive high-cost support. As we explain below, we will require all incumbent LECs to certify whether or not they will commit to offering broadband Internet access throughout their supported study areas in five years.[60] Those who make that commitment

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[59] Remarks of Commissioner Michael J. Copps, Pike & Fischer's Broadband Policy Summit IV, Washington, DC (June 12, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-282890A1.pdf.

[60] *See supra* note 56 (explaining use of the terms "study area" and "service area" in this order). We understand the concern of commenters who point out the need for more granular information on broadband availability. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481, para. 13; *see also* Comcast *High-Cost Reform NPRMs* Comments at 13-16; GCI *High-Cost Reform NPRMs* Comments at 34-36; NCTA *High-Cost Reform NPRMs* Comments at 20; New Jersey Rate Counsel *High-Cost Reform NPRMs* Comments at 21-22; New York State PSC *Joint Board Comprehensive Reform NPRM* Comments at 1, 5-6; TCA *High-Cost Reform NPRMs* Comments at 11-12; USTelecom *High-Cost Reform NPRMs* Comments at 36; Embarq *High-Cost Reform NPRMs* Reply at 8-10. The Commission has recently undertaken a major effort to gather more specific and granular data about broadband subscribership and availability. *See Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Intercon-*

will continue to receive their current levels of support. Existing competitive ETCs likewise will have the opportunity to commit to offering broadband Internet access service throughout their supported service areas, and will be eligible to receive high-cost support based on their actual costs. Auction winners, as well, must commit to offering broadband Internet access service throughout their supported areas as a condition of receiving even initial support. In other words, all ETCs are subject to the same basic obligation—to offer broadband Internet access throughout their supported service areas. We also explain the obligations related to this condition, including carrier-of-last-resort-type obligations.

21. We believe that imposing this condition on the receipt of high-cost support is fully consistent with and indeed promotes Congress's overall objectives as stated in section 254 of the Communications Act and section 706 of the 1996 Act.[61] Section 254(b)(2) of the Act instructs the

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nected Voice over Internet Protocol (VoIP) Subscribership, WC Docket No. 07-38, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 9691, 9708-09, paras. 34-35 (2008) (*Broadband Data Gathering Order*) (seeking comment on, among other things, adopting a national broadband mapping program). We believe our refined broadband data gathering program will help all of us better assess where our broadband availability needs are greatest. For purposes of implementing the broadband deployment program of this order, we ask incumbent LECs to identify where they will and will not commit to broadband availability, thus identifying where we need to proceed to a reverse auction.

[61] 47 U.S.C. §§ 157 nt, 254. Some commenters suggest that adding broadband Internet access service to the list of "supported services" would be inconsistent with section 254(c)(1) of the Act because broadband Internet access service is an information service, not a telecommunications service. *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 30-31; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 31-32; SouthernLINC *High-Cost Re-*

Commission to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[62] Similarly, section 254(b)(3) states that "[c]onsumers . . . in rural, insular, and high-cost areas, should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[63] Indeed, Congress even established the definition of universal service as "an *evolving* level of telecommunications services . . . taking into account advances in telecommunications and information technologies and services."[64] We believe that imposing a broadband condition on receipt of high-cost support advances the general purposes of section 254 of the

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form NPRMs Reply at 42-43; Sprint Nextel *High-Cost Reform NPRMs* Reply at 16-17. Using the universal service program to ensure universal broadband availability, however, is fully consistent with the statute as explained above. In addition, section 254(c)(2) provides that "[t]he Joint Board may, from time to time, recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms." 47 U.S.C. § 254(c)(2). The Joint Board did just that in the *Comprehensive Reform Recommended Decision*, in which it recommended that we add broadband Internet access service to the list of services eligible for support under section 254. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20491, para. 56. In this order, we achieve the Joint Board's goal by conditioning receipt of federal high-cost support on an ETC's commitment to offer broadband Internet access service throughout its service area, but we do not add broadband Internet access service to the list of universal service supported services.

[62] 47 U.S.C. § 254(b)(2) (emphasis added).

[63] 47 U.S.C. § 254(b)(3) (emphasis added).

[64] 47 U.S.C. § 254(c)(1) (emphasis added).

Act as just described and also advances Congress's objective stated in section 706 of the 1996 Act to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."[62] We also see no reason why conditioning the receipt of high-cost support on offering broadband Internet access service is not permissible under the Commission's authority to promulgate general rules related to universal service.[63]

22. *Broadband Internet Access As a Condition to Receiving High-Cost Support.* Consistent with the objectives of sections 254 and 706 as just described, all ETCs must offer broadband Internet access service to all customers in their supported service areas as a condition of receiving universal service high-cost support. Since the Commission adopted universal service rules in response to the 1996 Act, broadband Internet access service has evolved into a critical service for American consumers. The importance of this evolution is reflected in Congress's recent finding that "[t]he deployment and adoption of broadband technology has resulted in enhanced economic development and public safety for communities across the Nation, improved heath care and education opportunities, and a better quality of life for all Americans, [and] [c]ontinued progress in the deployment and

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[62] 47 U.S.C. §§ 157 nt, 254.

[63] The Commission has previously considered imposing conditions on the receipt of high-cost support. *See Universal Service First Report and Order*, 12 FCC Rcd at 8831, para. 98. And of course, today's recipients of high cost support must comply with many obligations that are not explicitly spelled out in the statute. For example, to be designated as an ETC, an applicant must demonstrate that it has back-up power. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 20 FCC Rcd 6371, 6382, para. 25 (2005) (*ETC Designation Order*).

adoption of broadband technology is vital to ensuring that our Nation remains competitive and continues to create business and job growth."[67] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and so many other uses.[68] Broadband Internet access plays a special role in rural areas, reducing the burdens of distance.[69] For example, high-speed connections to the Internet allow children in rural areas to have access to the same information as school children in urban areas. Telemedicine networks

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[67] Broadband Data Improvement Act, Pub. L. No. 100-385, 122 Stat. 4096, § 102(1)-(2) (2008).

[68] A recent survey finds that, compared to Internet users with dial-up service at home, those with broadband service at home are far more likely to engage in 14 different types of Internet-related activities on a typical day. These activities include using an online search engine, checking for weather reports, getting news, visiting a state or local government Web site, obtaining job information, watching a video, and downloading a podcast. The daily use of a search engine, for example, is reported by 57% of the broadband users as compared to only 26% of the dial-up users. *See* JOHN B. HORRIGAN, PEW INTERNET & AMERICAN LIFE PROJECT, HOME BROADBAND ADOPTION 2008 at 19 (2008) (2008 PEW BROADBAND ADOPTION STUDY), *available at* http://www.pewinternet.org/pdfs/PIP_Broadband_2008.pdf.

[69] For example, the California Broadband Task Force Report finds broadband service critical to expanding job opportunities for rural residents. It observes, for example, that broadband has facilitated the use of "homeshoring," or the use of home-based workers for providing customer service, instead of requiring employees to adhere to a strict work schedule at a centralized location. This report also finds that broadband offers farmers better access to market information and allows them to expand their potential customer base. *See* FINAL REPORT OF THE CALIFORNIA BROADBAND TASK FORCE at 13 (Jan. 2008) (CALIFORNIA 2008 BROADBAND REPORT), *available at* http://www.calink.ca.gov/taskforcereport/.

made possible by broadband Internet access service also save lives and improve the standard of healthcare in sparsely populated, rural areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[70] Broadband service also enables the sharing of critical, time-sensitive information with first responders, government officials, and health care providers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis in coordination.[71]

23. Despite the advances in broadband technology and the deployment of infrastructure to accommodate higher bandwidth speeds, ubiquitous broadband availability does not exist throughout the nation—especially for those consumers in rural areas.[72] In March 2008, the

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[70] *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111, 11112, para. 5 (2006); *see also* SUSANNAH FOX, PEW INTERNET & AMERICAN LIFE PROJECT, THE ENGAGED E-PATIENT POPULATION at 1 (2008) (finding that home broadband users are twice as likely as home dial-up users to do health research on a typical day), *available at* http://www.pewinternet.org/pdfs/PIP_Health_Aug08.pdf.

[71] A recent report to Congress concludes that "[m]odern broadband communications networks and applications present an enormous opportunity to radically improve the manner in which emergency information is shared by health officials. Broadband services enable bandwidth intensive information such as video, pictures, and graphics to be transmitted faster and in a more reliable and secure manner." JOINT ADVISORY COMMITTEE ON COMMUNICATIONS CAPABILITIES OF EMERGENCY MEDICAL AND PUBLIC HEALTH CARE FACILITIES, REPORT TO CONGRESS 2 (Feb. 4, 2008), *available at* http://energycommerce.house.gov/Press_110/JAC.Report_FINAL%20Jan.3.2008.pdf.

[72] *See, e.g.*, Cellular South *High-Cost Reform NPRMs* Comments at 10; *see also generally* 2008 PEW BROADBAND ADOPTION STUDY at 11-12.

Commission's most recent data revealed that more than half of the households in the United States now subscribe to a high-speed service provider and at least one high-speed service provider is providing service in excess of 200 kbps in at least one direction in 99.9 percent of zip codes in the country.[73] The broadband subscription rate is much lower in rural areas, however. A 2008 survey finds that the percentage of rural households subscribing to broadband service is only 38 percent—well below the 57 percent and 60 percent subscription rates found in urban and suburban areas, respectively.[74] This survey concludes that the lack of broadband availability very likely accounts for some of this disparity.[75] Moreover, this conclusion is consistent with the results of residential surveys in several states.[76] We find that making the offering

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[73] *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl 15 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-280906A1.pdf.

[74] *See* 2008 PEW BROADBAND ADOPTION STUDY at 3-4. The survey was conducted by phone from April 8, 2008 to May 11, 2008 among 2,251 American adults, 1,153 of whom were broadband users. *Id.*

[75] Pew acknowledges that the participants in its 2008 survey may report incorrectly as to whether broadband service is available where they live. 2008 PEW BROADBAND ADOPTION STUDY at 11. Pew nonetheless concludes that "the fact that rural residents are more likely to report that broadband isn't available where they live indicates that infrastructure availability comes into play in broadband adoption. Some 28% of rural adult Americans without home high-speed say broadband isn't available where they live, in contrast to 22% of non-rural Americans without broadband who say this. Moreover, 24% of dial-up users in rural areas say having the service available where they live would prompt a switch to broadband; this compares to the 14% figure for all respondents." *Id.* at 11-12.

[76] In Ohio, a March 2008 survey of 1,200 residents found broadband service available in 96% of urban homes but in only 79% of rural homes. *See* CONNECT OHIO TECHNOLOGY ASSESSMENT: EXECUTIVE SUMMARY at 2 (June 27, 2008), *available at* http://connectoh.org/

of broadband Internet access service a condition of receiving universal service high-cost support can bring this critical service to the remainder of Americans who await its deployment.[77] In addition, doing so will further the objective of section 254(b)(3) that consumers in rural, insular, and high-cost areas have access to advanced telecommunications and information services that are reasonably comparable to those services provided in urban

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_documents/Res_OHExecutiveSummary06252008_FINAL.pdf. In California, a state-commissioned task force recently found that approximately 500,000 California households, or almost 1.4 million California residents, are unable to subscribe to broadband service with a speed of at least 500 kbps. The task force identified 1,975 communities without broadband service and concluded that many California communities do not have access to the higher broadband speeds. *See* CALIFORNIA 2008 BROADBAND REPORT at 33. In Tennessee, a July 2007 survey of 1,787 residents having dial-up service at home found that 36% of them did not subscribe to broadband service because it was unavailable to their homes. *See* CONNECTED TENNESSEE, TENNESSEE RESIDENTIAL CONSUMERS at 22 (2007), *available at* http://www.connectedtn.org/_documents/CTResidentialSurvey100107.FINAL.pdf.

[77] We disagree with commenters who suggest that it is premature or ill-advised to require all ETCs to offer broadband because, as discussed below, we do so in a manner that does not increase the size of the high-cost fund. *See, e.g.*, SouthernLINC *High-Cost Reform NPRMs* Comments at 30; Sprint Nextel *High-Cost Reform NPRMs* Comments at 16-17; USTelecom *High-Cost Reform NPRMs* Comments at 33-34; Western Telecomms. Alliance (WTA) *High-Cost Reform NPRMs* Comments at 73; SouthernLINC *High-Cost Reform NPRMs* Reply at 41. Similarly, we disagree with commenters who argue that government action at the current time would be wasteful as the market is already taking steps to reach currently underserved areas. *See, e.g.*, NCTA *High-Cost Reform NPRMs* Comments at 19-20; SouthernLINC *High-Cost Reform NPRMs* Comments at 30; SouthernLINC *High-Cost Reform NPRMs* Reply at 42. We cannot wait indefinitely for the benefits of broadband to reach all Americans.

areas and that are available at rates charged for similar services in urban areas.[78]

a. Definition of Broadband Internet Access Service

24. For purposes of satisfying the condition to receive high-cost support, we adopt a definition of broadband Internet access service that focuses on the end user's experience, without regard to the types of facilities, protocols, or other technologies used to deliver that experience. Broadband Internet access service is therefore defined as an "always on" service that combines computer processing, information provision, and computer interactivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed elsewhere in this order.[79] We refer specifically to broadband Internet access service—an information service—and not to broadband transmission alone because our goal is to ensure that all Americans have access to the Internet.[80]

b. Broadband Internet Access Service Obligations

25. Section 254(b)(1) instructs the Commission to base policies for the advancement of universal service on the principle that quality services should be offered at

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[78] See 47 U.S.C. § 254(b)(3).

[79] *See infra* paras. 28, 45, 52; *see also Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14860-61, para. 9 (2005) (*Wireline Broadband Internet Access Order*), *aff'd sub nom. Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

[80] As explained below, nothing in this order changes the choice that providers have today to offer broadband transmission on a common carrier basis. *See infra* para. 26.

just, reasonable, and affordable rates.[81] Below we provide requirements for offering broadband Internet access service as a condition of receiving universal service high-cost support. In sum, all ETCs must offer broadband Internet access service, along with all supported services, to all customers throughout their service areas by the end of a five- or ten-year build-out period consistent with the requirements of this order.

26. Except as described just below, an ETC may offer broadband Internet access service using any technology, or combination of technologies, that meets the requirements for speed set forth in this order. An ETC may also combine services provided over its own facilities with those provided over another provider's facilities pursuant to agreement. Indeed, there may be service areas where it is more economic to offer broadband Internet access service via one technology than another and we explicitly provide for even a single provider to take advantage of the inherent benefits of different technologies for different areas.[82] Furthermore, an ETC can combine a common carrier offering of broadband transmission[83] with the information processing capabilities described above,[84] so long as what the end user receives is in fact broadband Internet access service.

27. An ETC cannot use satellite broadband technology to meet its obligations under this order, however,

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[81] 47 U.S.C. § 254(b)(1).

[82] Thus, we are not favoring wireline technology over another. *But see* Virgin Mobile *High-Cost Reform NPRMs* Reply at 5-6.

[83] *See Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14900-01, paras. 89-90 (giving providers of wireline broadband Internet access the choice to offer broadband transmission on a common carrier basis or a non-common carrier basis).

[84] *See supra* para. 24.

absent a waiver from the Commission. We are concerned that broadband Internet access service provided via satellite differs from broadband Internet access provided over other technologies in two important ways. First, satellite-provided broadband Internet access service is subject to latency due to the amount of time it takes a signal to travel between the satellite and the user.[85] Latency ranges from a quarter of a second to almost a second, making the use of applications that require a very fast response difficult or impossible, and substantially degrading the quality of other applications like voice over Internet protocol.[86] Second, satellite-provided broadband Internet access service is subject to degradation due to weather events ("rain fade") to a greater degree than

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[85] *See, e.g.*, COMPUTER SCIENCE AND TELECOMMUNICATIONS BOARD, NATIONAL RESEARCH COUNCIL, BROADBAND: BRINGING HOME THE BITS 145 (2002) (BRINGING HOME THE BITS); BroadbandInfo.com, Inside the World of Satellite Broadband, BroadbandInfo.com, http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last visited Nov. 3, 2008) (stating that because the satellites providing broadband signals orbit the earth approximately 22,300 miles above the surface, there is a lag time between the sending and receiving of the satellite broadband signal).

[86] *See* BRINGING HOME THE BITS 145 (explaining that for Internet telephony, the delay can cause a real degradation in usability); Jon Norwood, Overview of Satellite Internet—Comparing the Main Features of Broadband Satellite (Oct. 17, 2006), *available at* http://www.velocityguide.com/satellite/satellite-internet-comparison.html (last visited Oct. 24, 2008) (stating that signal delay to a satellite ranges from around 500 to 900 milliseconds, and that this latency can render any software that requires real-time user input problematic at best); BroadbandInfo.com, Inside the World of Satellite Broadband, *available at* http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last visited Oct. 24, 2008) (stating that for certain broadband Internet real-time applications, such as e-gaming, the latency is enough to cause severe interference with the application).

other wireless technologies.[87] For these reasons, we find that satellite-provided broadband Internet access service cannot be the primary means by which we serve rural America. We recognize, however, that for certain customers, satellite-provided broadband may be the only economic means of reaching them. Therefore, ETCs may apply to the Commission for a waiver to be able to meet their commitments under this order by offering broadband Internet access service via satellite to certain customers, based on a specific, detailed showing that there is no other economic option for serving those customers.[88] If the Commission grants such a waiver with regard to particular customers, that waiver may be transferred if a different ETC becomes subject to the obligation to offer broadband to those customers.

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[87] *See, e.g., Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, Second Report, 15 FCC Rcd 20913, 20938, para. 59 (2000) (explaining that areas subject to extreme rain or snow may have difficulty receiving satellite signals in those conditions, and describing it as a limitation to satellite Internet last-mile facilities); *see also* Howstuffworks.com, How Does Satellite Internet Operate?, http://computer.howstuffworks.com/question606.html (last visited Oct. 24, 2008) (explaining that, as for satellite TV, heavy rains can affect reception of Internet signals); Skycasters, Broadband Satellite Internet: 99.44% System Reliability, http://www.skycasters.com/satellite-internet-service-specs/system-reliability.html (last visited Oct. 31, 2008) (explaining that rain fade is a short duration period during which the loss of satellite service occurs when intense storm cells are located directly between the satellite and the satellite dish).

[88] If the Commission grants a waiver allowing the use of satellite service, the ETC may not charge a higher price to customers served by satellite than it charges to customers served by another broadband technology.

3. Incumbent LECs' Commitment to Offer Broadband

28. As discussed above, as a condition of receiving federal high-cost universal service support, all ETCs must offer broadband Internet access service.[89] Therefore, incumbent LECs receiving high-cost support must certify to the Commission, for each study area[90] for which they receive high-cost support, whether or not they will offer broadband Internet access service to all customers within that study area, consistent with the requirements of this order, within five years of the due date of their commitment.[91] This certification must include a commitment to offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[92]

29. Incumbent LECs that file a certification for a particular study area indicating that they will offer broadband Internet access service under the terms specified in this order will continue to receive their current levels of high-cost support for that study area, which will be deemed a "Committed Study Area." We specify the precise benchmarks that the incumbent LEC must meet

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[89] *See supra* paras. 19-27.

[90] *See supra* note 195 (explaining the use of the terms "study area" and "service area" in this order).

[91] The Wireline Competition Bureau (Bureau) will release a public notice at a future date specifying the manner and due date of the certification. Other reporting, monitoring, and milestone requirements are set forth below. *See infra* paras. 57-63.

[92] This tier of broadband is similar to the tier described as "Basic Broadband Tier 1" in our *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700-01, para. 20 & n.66.

over the five-year build-out period, and the consequences for failure to do so, below.[93]

30. As discussed above, we freeze each incumbent LEC ETC's individual high-cost support at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[94] Incumbent LEC ETCs committing to offer broadband Internet access service within a study area consistent with the requirements of this order will continue to receive the frozen high-cost support amount for that study area.[95]

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[93] *See infra* paras. 57-63.

[94] *See supra* para. 16.

[95] Some incumbent LECs assert that they will not be able to commit to provide broadband Internet access service to all customers within their study areas at the frozen level of support. *See, e.g.*, Letter from Eric N. Einhorn, V.P. Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 06-122, 08-152, 07-135, at 3 (filed Oct. 27, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket No. 05-337, at 2 (filed Oct. 20, 2008); Letter from Daniel Mitchell, Vice President Legal & Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 04-36, at 1-2 (filed Oct. 28, 2008). First, to the extent incumbent LECs cannot build out their networks to provide broadband to all customers in their study areas, they may seek a waiver to provide service via satellite technology, as discussed above. Second, universal service support is not meant to subsidize high-cost carriers, but rather it is meant to support customers in high-cost areas. *See Alenco*, 201 F.3d at 620 ("The Act only promises universal service, and that is a goal that requires sufficient funding of customers, not providers. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local tele-

31. Study areas for which incumbent LECs either certify that they will not offer broadband in five years as described herein, or for which the incumbent LECs fail to file any certification at all, will be deemed "Unserved Study Areas." For these areas, the Commission will conduct a reverse auction as described below, awarding high-cost support to a bidder that will commit to take on carrier of last resort obligations and to offer broadband Internet access service throughout the study area.

4. Reverse Auctions for Study Areas Unserved by Broadband

32. The Joint Board recommended that the Commission's universal service goals include universal availability of broadband Internet service at affordable and comparable rates for all rural and non-rural areas.[96] While we are not adopting the Joint Board's recommendation to create a separate broadband fund, we agree with the Joint Board's goal that broadband Internet access service should be universally and affordably available. We are therefore allowing incumbent LECs and competitive ETCs receiving high-cost support to continue to receive such support if they commit to offer broadband services throughout their supported service areas by the end of a five-year build-out period. We anticipate, however, that in some study areas, the incumbent LEC may decline to make that commitment. For

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phone provider as well."). Therefore, if an incumbent LEC cannot provide broadband service at the frozen support levels, support will go to a reverse auction winning bidder who can provide such service at or below that level on a more efficient basis. Finally, as discussed below, to the extent that a reverse auction does not produce a winning bidder, the Commission will reexamine support to that study area.

[96] *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20491-92, paras. 56-62.

these Unserved Study Areas, we will conduct a reverse auction for the right to receive high-cost support.[97]

33. We sought comment in our *Reverse Auctions NPRM* on the merits of using reverse auctions, a form of competitive bidding, to decide how much high-cost support to provide to ETCs serving rural, insular, and high-cost areas.[98] In a reverse auction, support generally would be determined by the lowest bid to serve the auctioned area.[99] We conclude that using a reverse auction method for identifying both the recipient of high-cost support for an Unserved Study Area, as well as the amount of support, is appropriate because the winning bid should approach the minimum level of subsidy required to achieve our universal service goals.[100] In contrast, a support mechanism based on cost or on a cost model provides no incentive for an ETC to provide supported services at the minimum possible cost.[101] In addi-

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[97] Many commenters, in particular those representing rural telephone companies, opposed the use of reverse auctions to award high-cost support to carriers of last resort in rural areas. *See, e.g.*, OPASTCO *Reverse Auctions* Comments at 16-21; NTCA *Reverse Auctions* Comments at 30-46. Under the measures we adopt today, reverse auctions will be conducted only in study areas for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service.

[98] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 10.

[99] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[100] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 7 (supporting reverse auctions as a means of controlling and reducing the size of the universal service fund, while putting the burden on providers to estimate bid amounts); Comcast *High-Cost Reform NPRMs* Comments at 7 (noting that the use of reverse auctions could reduce the size of the high-cost fund significantly).

[101] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Letter from Grover Norquist, Americans for Tax Reform, to Marlene

tion, a reverse auction provides a fair and efficient means of eliminating or reducing the subsidization of multiple ETCs in a given region.[102] For these reasons, we find that a reverse auction offers advantages over the current high-cost support distribution mechanisms and we adopt a reverse auction plan, as discussed below.[103]

34. To implement the reverse auctions, there are several issues that must be addressed. We describe in this part: (1) the geographic area to be auctioned; (2) the reserve price for the reverse auction; (3) what a winning bidder will receive; (4) how the winning bidder will be selected; and (5) the qualifications a bidder must demonstrate before it may participate in a reverse auction.

a. Geographic Area

35. In the *Reverse Auctions NPRM*, we sought comment on whether we should use the study area[104] as the

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Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 1 (filed Apr. 14, 2008) (arguing that reverse auctions will create incentives to invest in rural communities and will not finance and subsidize wasteful carriers).

[102] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[103] Although several rural LEC commenters oppose the use of reverse auctions to distribute high-cost support, as discussed above, incumbent LECs will not be required to participate in a reverse auction to receive support, so long as they commit to deploy broadband throughout their study areas. *See, e.g.*, ATA *High Cost Reform NPRMs* Comments at 13-15 (opposing the use of reverse auctions); Alexicon *Reverse Auctions NPRM* Comments at 2-3 (opposing reverse auctions for rural LECs).

[104] A study area is a geographic segment of an incumbent LEC's telephone operations. Generally, a study area corresponds to an incumbent LEC's entire service territory within a state. *Direct Communications Cedar Valley, LLC and Qwest Corporation Joint Petition for Waiver of the Definition of "Study Area" of the Appendix-Glossary of Part 36 of the Commission's Rules, Petition for Waiver of Section 69.2(hh) and 69.605(c) of the Commission's Rules*, CC

geographic area for reverse auctions.[166] We observed that high-cost support today is generally based on the wireline incumbent LEC's study area.[167] We tentatively concluded that the wireline incumbent LEC's study area would be the appropriate geographic area on which to base reverse auctions.[168] We adopt our tentative conclusion that the study area is the best geographic area to use for several reasons. First, if we allowed bidders to bid to provide service in smaller geographic areas, we would encourage bidders to bid on areas that are easier or cheaper to serve, leaving our most difficult-to-serve populations still without broadband service.[169] Conversely, if we required bidders to bid on even larger geographic areas, we might discourage bidders from entering the auction because of the difficulty in committing to serve an even larger area. Although some commenters

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Docket No. 96-45, Order, 20 FCC Rcd 19180, 19181, para. 2 (WCB 2005). Section 54.207 of the Commission's rules provides that a rural telephone company's service area will be its study area "unless and until the Commission and the states, after taking into account recommendations of a Federal-State Joint Board instituted under section 410(c) of the Act, establish a different definition of service area for such company." 47 C.F.R. § 54.207(b); 47 U.S.C. § 214(e)(5). As discussed above, we use the terms "study area" and "service area" interchangeably in this order. *See supra* note 195.

[166] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20.

[167] *Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20.

[168] *Reverse Auctions NPRM*, 23 FCC Rcd at 1504, para. 21.

[169] Thus, we disagree with commenters' arguments that we should hold auctions for small geographic areas, such as counties, census block groups, or zip codes. *See, e.g.*, Comcast *High Cost Reform NPRMs* Comments at 9; NCTA *High Cost Reform NPRMs* Comments at 16; SouthernLINC *High Cost Reform NPRMs* Comments at 24-25; TracFone *High-Cost Reform NPRMs* Comments at 6.

oppose using the incumbent LEC's study area,[109] use of the study area is consistent with the area we ask incumbent LECs to consider in making their commitments. Finally, selecting smaller geographic areas for auction would increase the number of auctions to be held, potentially delaying the conduct of the auction and, therefore, the deployment of broadband to unserved areas.[110] For these reasons, we conclude that the study area is the best available geographic area to consider for the auction. We will conduct a reverse auction for each study area for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service pursuant to the requirements explained above (Unserved Study Areas).[111]

b. Reserve Price

36. In the *Reverse Auctions NPRM*, we noted that we should establish a reserve price—a maximum level of high-cost support that participants in the auction would be allowed to place as a bid.[112] We observed that a reserve price that is set too low is likely to discourage bidders from participating, while one that is set too high raises the possibility of providing too much support.[113]

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[109] *See, e.g.*, Comcast *High-Cost Reform NPRMs* Comments at 8-9; NCTA *High-Cost Reform NPRMs* Comments at 16; SouthernLINC *High-Cost Reform NPRMs* Comments at 25; TracFone *High-Cost Reform NPRMs* Comments at 5.

[110] *See* Ohio PUC *Reverse Auctions NPRM* Comments at 6-7 (generally agreeing that the incumbent LEC's study area is the appropriate geographic area on which to base reverse auctions because further disaggregation could add cost and delays, and increase the opportunity for creamskimming).

[111] *See supra* paras. 19-31.

[112] *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

[113] *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

We conclude that the reserve price should be the amount of high-cost support that the incumbent LEC would have been entitled to receive had it committed to offer broadband Internet access service within the study area.[114]

37. We set the reserve price in each study area at the incumbent LEC's current level of high-cost support for several reasons. First, we are capping the overall high-cost fund at its current level. Setting a reserve price will help ensure that overall high-cost funding remains within this amount, because the high-cost funding for each Unserved Study Area will merely be transferred to another ETC, not increased. In addition, setting a reserve price at this level will ensure that, even in reverse auctions for particular Unserved Study Areas that do not garner many bids, those bids will be made by providers who are confident that they can assume all the obligations of the carrier of last resort,[115] as well as the new broadband service obligations, and provide service more efficiently than the incumbent LEC.[116] Indeed, we expect that bidders

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[114] *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 22 n.63 ("The Commission would start bidding at current support levels."). As discussed above, each incumbent LEC ETC's individual high-cost support is frozen at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area basis. *See supra* paras. 16, 30.

[115] Carrier of last resort obligations for incumbent LECs are a matter of state law. Under section 214(e)(6), when the state lacks jurisdiction, the Commission shall make the public interest determination on whether to designate a carrier an ETC. 47 U.S.C. § 214(e)(6). The ETC requirements include a requirement to provide supported services throughout the service area. 47 U.S.C. § 214(e)(1).

[116] Some commenters oppose setting the reserve price at current incumbent LEC levels, or setting any reserve price. *See* OPASTCO *High-Cost Reform NPRMs* Comments at 19-20; MSTC Group *High-Cost Reform NPRMs* Comments at 17-18; North Dakota PSC *High-*

frequently will offer to provide service using newer and more efficient technologies than the incumbent LEC uses today. For these reasons, we set the reserve price at the level described above.

c. Auctioned Support

38. For Unserved Study Areas, we will auction the award of high-cost support to provide all supported services to the entire Unserved Study Area, on a carrier of last resort basis, consistent with the requirements of this order. The maximum annual award amount will be equal to the amount of the winning bid (Award Amount), paid out as described in more detail below as certain geographic areas are built out.[117]

39. The Award Amount is conditioned on the winning bidder providing all supported services as a carrier of last resort, as the incumbent LEC does today under state law, and meeting the ETC requirements set forth in the *ETC Designation Order*.[118] Competitive ETCs are cur-

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Cost Reform NPRMs Comments at 5. We find that setting the reserve price at the incumbent LEC support level will provide certainty to bidders and enable bidders with more efficient technologies to provide broadband in areas where incumbent LECs do not commit to do so. Furthermore, as discussed below, if a reverse auction provides no winner, the Commission will examine the need for further action. *See infra* para. 47.

[117] A competitive ETC that currently serves all or a portion of an Unserved Study Area will not receive high-cost support for the same service area as both a winning bidder and based upon a showing of its own costs. If a competitive ETC that already receives high-cost support within this study area wins the auction, it will lose its existing high-cost support for particular geographic areas as it begins to receive its Award Amount for those areas.

[118] *ETC Designation Order*, 20 FCC Rcd 6371. Section 214(e)(6) of the Act gives the Commission authority to designate carriers as ETCs when those carriers are not subject to the jurisdiction of a state commission. 47 U.S.C. § 214(e)(6). The requirements in the

rently required to provide supported services throughout their service area, even though they may not be, under state law, the carrier of last resort.[119] In the *ETC Designation Order*, the Commission adopted additional requirements for ETC designation proceedings in which the Commission acts pursuant to section 214(e)(6).[120] The Commission requires that applicants seeking ETC designation from this Commission demonstrate the following: (1) a commitment and ability to provide services, including providing service to all customers within its proposed service area; (2) that it will remain functional in emergency situations; (3) that it will satisfy consumer protection and service quality standards; (4) that it offers local usage comparable to that offered by the incumbent LEC; and (5) an understanding that it may be required to provide equal access if all other ETCs in the designated service area relinquish their designations pursuant to section 214(e)(4).[121] We find that the universal service obligations in the *ETC Designation Order* will apply to all competitive ETCs winning reverse auctions; in addition, the auction winner must accept all of the carrier of last resort obligations of the incumbent LEC for that study area, whether such obligations are imposed on the LEC pursuant to state or federal law.

40. In addition to the *ETC Designation Order* requirements, we add two additional requirements to com-

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ETC Designation Order currently apply only to Commission-designated ETCs, although the Commission, in that order, encouraged state commissions to adopt similar requirements. *ETC Designation Order*, 20 FCC Rcd at 6372, 6379, paras. 1, 19.

[119] *See* 47 U.S.C. § 214(e)(1).

[120] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20.

[121] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20; 47 U.S.C. § 214(e)(4).

petitive ETCs winning reverse auctions. First, they must, as a condition of receiving the Award Amount, offer broadband Internet access service to all customers within the Unserved Study Area. Second, competitive ETCs winning reverse auctions must offer supported services at a retail price comparable to the retail price charged by the incumbent LEC in that same study area for the same or equivalent service.[122] In this manner, we ensure that competitive ETCs receiving high-cost support will continue to make supported services at least as affordable and available as they are today.

41. We recognize that a transition mechanism is needed to shift high-cost support from the incumbent LEC currently receiving it to another ETC that wins an Award Amount. A flash cut would be harmful in at least two ways. First, the incumbent LEC would immediately lose support upon which it may rely to maintain supported services as a carrier of last resort to consumers today. It is possible that removing support from the incumbent LEC would, in some cases, jeopardize its provision of services to some users. In addition, granting a full Award Amount immediately to a winning ETC would provide little incentive for the competitive ETC to build out new facilities to difficult-to-serve areas until the last possible moment, as in many cases those areas will be the most expensive to serve. As a result, we conclude that, prior to the initiation of an auction, the incumbent LEC for the Unserved Study Area will be required to identify

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[122] In adopting this requirement, we are not setting any specific rates, nor does this requirement conflict with the states' jurisdiction over intrastate rates. Instead, we are conditioning the receipt of federal universal service support on an ETC's provision, on a voluntary basis, of rates comparable to the incumbent LEC's for equivalent services.

the distribution of support by geographic area for purposes of the auction and the transfer of support to the winning bidder. As the winning ETC builds out to those geographic areas and certifies that it complies with all its obligations under this order for that area, it will receive high-cost support for that portion of the Unserved Study Area, and the incumbent LEC will no longer receive such support for that area.[123] As the winning bidder takes on carrier of last resort obligations and obtains high-cost support for an area, the incumbent LEC will no longer receive high-cost support for that area and will be relieved of its carrier of last resort obligations at both the state and federal levels. We require winning auction bidders to comply fully with all the requirements of this order by the end of a ten-year build-out period.

42. Finally, we address the question of transferability of the Award Amount. We conclude that auction winners may transfer their right to the Award Amount. This transfer could take one of several forms—an auction winner could be purchased by another entity, the winner could sell assets used to provide the supported services, or the auction winner could transfer just the right to the Award Amount itself. The transferee will, in all events, step into the shoes of the auction winner and will be responsible for meeting all obligations as if it had been the

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[123] The amount of support to be awarded to the winning bidder could be less than the amount of support received by the incumbent LEC for that same area. The transfer of support will be based on the amount of support, relative to support for the entire study area, received by the incumbent LEC for the area to be transferred; that same relative percentage will be used to calculate the amount of award support the auction winner should receive for the same area. In no event will an incumbent LEC who is not an auction winner continue to receive support for an area once an auction winner begins to receive support for that same area.

original auction winner. Any such transfer, however, must be authorized by the Commission before it is consummated.

d. Selecting a Winning Bid

43. In the *Reverse Auctions NPRM*, we sought comment on whether the reverse auction should award high-cost support to a single winner or to multiple winners.[124] We observed that if only one winner receives support, this could provide a fair and efficient means of eliminating the subsidization of multiple ETCs in a region, particularly in areas in which costs are prohibitive.[125] We tentatively concluded that universal service support auctions should award high-cost support to a single winner.[126] We now conclude that the single winner format will provide the most effective mechanism for determining the support amount sufficient to meet the universal service goals in any given area.[127] We therefore adopt our tentative conclusion to select one winner in each reverse auction.

44. As we have explained above, in requiring the offering of broadband Internet access service as a condi-

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[124] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 13.

[125] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14.

[126] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14

[127] *See, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 4-5; New York PSC *Identical Support and Reverse Auctions NPRMs* Comments at 2-3; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 21-22, App. at 12. We disagree with commenters who support multiple winner auctions. *See, e.g.*, Alltel *High-Cost Reform NPRMs* Comments at 40-41; Atlantic TeleNetwork *Identical Support and Reverse Auctions NPRMs* Comments at 13. We find that supporting a single auction winner is a more efficient means of ensuring the provision of broadband Internet access in areas where the incumbent LEC has determined that the costs of serving all customers in the area is prohibitive.

tion of receiving high-cost support, one of our main goals is to ensure that all Americans have access to affordable, quality broadband services.[128] Achieving this goal will require careful selection of the winning bidder for a particular Unserved Study Area. As explained in more detail below, the winning bidder will be the one who commits to offer the highest speed of broadband service—throughout the entire Unserved Study Area—at a bid amount that is equal to or less than the reserve price (the incumbent LEC's current high-cost support amount). In so doing, we work towards making quality, technologically advanced broadband services available to all Americans, including those in difficult- or expensive-to-serve areas, rather than settling for lesser broadband service for those Americans who live in high-cost areas. We acknowledge that, in many cases, the winning bid will not be the cheapest one. But we believe that encouraging bidders to offer better broadband services at or below a set reserve price will help us achieve our broadband goals, while keeping an appropriate limit on the amount of high-cost support disbursed to achieve that goal.

45. For purposes of our reverse auction, we establish three tiers of broadband service. We will use the term "Basic Broadband Tier 1" to refer to service with download speeds equal to or greater than 768 kbps but less than 1.5 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 2" to refer to service with download speeds equal to or greater than 1.5 mbps and less than 3 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 3" to refer to service with download speeds equal to or

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[128] *See supra* paras. 19-23.

greater than 3 mbps, and upload speeds greater than 200 kbps.[129]

46. We will evaluate bids as follows: for any Unserved Study Area, a bidder will submit a bid to commit to offering a service falling within Basic Broadband Tier 1, Broadband Tier 2, or Broadband Tier 3 to all customers in the Unserved Study Area. To qualify for an award, the bid must be equal to or less than the reserve price—that is, equal to or less than the amount of high-cost support received by the incumbent LEC for that Unserved Study Area.[130] The bidder need not specify a specific speed to which it will commit in any of the three tiers, but it must disclose in which tier its proposed service will fall. The bid amount will be an amount of high-cost support to provide all supported services in the Unserved Study Area as carrier of last resort, subject to all the requirements of this order, including the condition to offer broadband throughout the Unserved Study Area. The winning bid will be selected through a two-step process. First, we will identify the highest speed tier for which there is a valid bid. If there is only one bid for that tier, then that is the winning bid. If there are multiple bids within that tier, then the winning bid will be the lowest price bid within that tier.[131]

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[129] These terms are similar, but not identical, to terms used in our latest *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700-01, para. 20 & n.66.

[130] *See supra* paras. 16-36.

[131] For example, assume the Commission conducted a reverse auction for an Unserved Study Area with a reserve price of $5 and received four bids: $1 to offer Basic Broadband Tier 1, $2 to offer Broadband Tier 2, $3 to offer Broadband Tier 3, and $4 to offer Broadband Tier 3. In that scenario, the winning bid amount would be $3 to offer Broadband Tier 3.

47. If a particular reverse auction produces no winner, the study area will be identified as a truly high-cost study area. The fact that there is no winning bidder may indicate that the reserve price was set at too low an amount of support. The Commission will reexamine any such study area to determine whether the frozen high-cost support amount is sufficient, and, if it is not, the Commission will determine what further actions should be taken to ensure that the study area is served by a provider that will meet the broadband commitment and carrier of last resort requirements. For example, the Commission may consider disaggregating the study area on a wire center basis for reverse auction purposes, or increasing the amount of high-cost support set as the reserve price for the study area.[132] To ensure continued service to customers during the limited period of time in which the Commission examines these issues, the existing incumbent LEC will continue to have all carrier of last resort and ETC obligations, and will continue to receive high-cost support frozen at its current level pending transfer of such support to the winning bidder of the reverse auction.

e. Bidder Qualifications

48. We adopt a number of conditions that bidders must meet before they can participate in any auction. We adopt these requirements to help ensure that any bidder who wins an auction will be capable of meeting the commitments that flow from being a winning bidder.

49. First, we require that a bidder be an ETC, certified by the Commission or by a state. In the *Reverse*

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[132] *See* Free Press Oct. 24, 2008 *Ex Parte* Letter at 12 (arguing that, if a study area receives no winning bidder in a reverse auction, then the study area should be disaggregated).

Auctions NPRM, we tentatively concluded that an auction bidder must be an ETC covering the relevant geographic area prior to participating in the auction.[133] We hereby adopt that tentative conclusion. Winning bidders must be designated as ETCs before receiving high-cost support pursuant to sections 214 and 254 of the Act; therefore, requiring bidders to receive this designation prior to participating in an auction entails only a small additional burden. This burden is offset by the potential delay in deploying broadband Internet access service that would result while a non-ETC winning bidder seeks and obtains ETC designation.[134] We note that ETCs are not required to provide all supported services with their own facilities.[135] ETCs may enter into contracts with other entities to provide some supported services in part or all of the study area.

50. As a general matter, in our spectrum auctions we require an upfront payment to deter frivolous or insin-

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[133] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500-01, para. 12; *see also, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 5; Indiana Util. Reg. Comm'n *High-Cost Reform NPRMs* Comments at 12; MSTC Group *High-Cost Reform NPRMs* Comments at 12; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments, App. at 8.

[134] For this reason, we disagree with commenters who argue that we should not require bidders to be ETCs. *See* GCI *High Cost Reform NPRMs* Comments at 89; Consumers Union (CU) et al. *High-Cost Reform NPRMs* Reply at 17.

[135] Pursuant to section 214(e)(1)(A) of the Act, a common carrier designated as an ETC must offer the services supported by the federal universal service mechanisms throughout the designated service area either by using its own facilities or by using a combination of its own facilities and resale of another carrier's services (including the services offered by another ETC). 47 U.S.C. § 214(e)(1)(A).

cere bidding.[136] In the reverse auctions we adopt today, we are not requiring an upfront payment. Instead, we are requiring participants to demonstrate to the Commission a capability to meet the milestone requirements. This showing will include, for example, evidence of financial resources with which to undertake the construction or upgrading of facilities necessary to offer broadband Internet access service. In addition, in areas where the bidder does not currently offer telecommunications services, we will require the bidder to submit a plan demonstrating the timetable for building the necessary facilities and obtaining any required permits.

5. Competitive Eligible Telecommunications Carriers

a. Background

51. In the *Identical Support NPRM*, the Commission tentatively concluded that it should eliminate the current identical support rule for competitive ETCs, because the rule bears no relationship to the amount of money competitive ETCs have invested in rural and other high-cost areas of the country.[137] In that notice, the Commission tentatively concluded that a competitive ETC should re-

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[136] *See, e.g., Auction of LPTV and TV Translator Digital Companion Channels Scheduled for November 5, 2008*, AU Docket No. 08-22, Public Notice, DA 08-1944, para. 53 (WTB 2008).

[137] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5; *see, e.g.*, Embarq *High-Cost Reform NPRMs* Comments at 10 ("It is logically inconsistent to compensate a carrier for serving 'high-cost' areas when there is no evidence—in the form of cost studies, filings, or model results—that the areas being supported are indeed 'high-cost' for that carrier."); Frontier *High-Cost Reform NPRMs* Comments at 4 (asserting that identical support is merely a subsidy to competitive ETCs, "and there is no basis to tell whether consumers are getting any [u]niversal [s]ervice benefits whatsoever" from subsidizing competitive ETCs in this manner).

ceive high-cost support based on its own costs, which better reflect real investment in rural and other high-cost areas of the country, and which create greater incentives for investment in those areas.[138] Because a competitive ETC's per-line support is based solely on the per-line support received by the incumbent LEC, rather than its own network investments in an area, the competitive ETC has little incentive to invest in, or expand, its own facilities in areas with low population densities, thereby contravening the Act's universal service goal of improving the access to telecommunications services in rural, insular and high-cost areas.[139] Instead, competitive ETCs have a greater incentive to expand the number of subscribers, particularly those located in the lower-cost parts of high-cost areas, rather than to expand the geographic scope of their networks. As discussed above, the Joint Board recommended elimination of the identical support rule; we agree with the Joint Board and adopt this recommendation and our tentative conclusion.[140] Under the new high-cost support mechanism that we adopt today, competitive ETCs will be eligible to receive support based on their own costs as compared to the relevant support benchmarks, contingent upon a commit-

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[138] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5.

[139] *See* 47 U.S.C. § 254(b)(3); Alabama PSC *High-Cost Reform NPRMs* Comments at 3 ("The identical support rule provides little incentive for ETCs to invest in building their own facilities in rural areas with low population densities because their support currently is based solely on the per-line support received by the incumbent, instead of investment in the network.").

[140] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 5 (recommending elimination of the identical support rule, which "bears little or no relationship to the amount of money competitive ETCs have invested in rural and other high cost areas of the country").

ment to offer broadband Internet access service to all customers in a service area within five years.[141]

b. Certification by Existing Competitive ETCs

52. As discussed above, as a condition of continuing to receive federal high-cost universal service support, incumbent LEC ETCs must offer broadband Internet access service to all customers in their service areas within five years.[142] Similarly, to be eligible to receive high-cost support on a going-forward basis, competitive ETCs must also certify that they will offer broadband Internet access service to all customers within a supported service area, consistent with the requirements of this order, within five years of the due date of their commitment.[143] Consistent with the certification required of incumbent LEC ETCs, competitive ETC certifications must include a commitment to offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[144] Failure to make this commitment or to meet the milestones and re-

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[141] The calculation of support provisions in this Part apply to competitive ETCs that do not receive high-cost support as the result of winning a reverse auction. Support for winning auction bidders, including competitive ETCs, will be based on the bid amount, as discussed above. *See supra* paras. 43-47.

[142] *See supra* para. 28.

[143] The Bureau will release a public notice at a future date specifying the manner and due date of the certification. Other reporting, monitoring, and benchmark requirements are set forth below. *See infra* paras. 57-63.

[144] This tier of broadband is similar to the tier described as "Basic Broadband Tier 1" in our *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700-01, para. 20 & n.66.

quirements established herein shall result in loss of ETC status for the service area.

c. Calculation of Support

53. We adopt our tentative conclusion in the *Identical Support NPRM* that competitive ETCs should receive high-cost support based on their own costs.[145] We are not persuaded by arguments that, by requiring competitive ETCs to demonstrate that their own costs exceed a high-cost threshold as a condition of receiving universal service support, we will be placing undue administrative burdens on the competitive ETCs and providing incentives for them to maximize their costs.[146] Instead, we find that competitive ETCs should demonstrate eligibility for high-cost support in the same manner as incumbent LEC ETCs, based on their costs, as this will better reflect competitive ETCs' investment in their service areas.[147]

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[145] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5.

[146] *See* GCI *High-Cost Reform NPRMs* Comments at 5, 40, 65-67; Oregon PUC *High-Cost Reform NPRMs* Comments at 5; Rural Cellular Ass'n (Rural Cellular) Identical Support and *Reverse Auctions NPRMs* Comments at 2; USCellular *High-Cost Reform NPRMs* Comments at 7, 38-40; USTelecom *High-Cost Reform NPRMs* Comments at 16; Wyoming Office of Consumer Advocate (Wyoming OCA) *Identical Support NPRM* Comments at 2; SouthernLINC *High-Cost Reform NPRMs* Reply at 13.

[147] Many commenters favor basing competitive ETCs' support on their own costs. *See* ATA *High-Cost Reform NPRMs* Comments at 3; Alexicon *Identical Support NPRM* Comments at 3-4; CenturyTel *High-Cost Reform NPRMs* Comments at 21-22; Connecticut Dept. of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 2-3; Embarq *High-Cost Reform NPRMs* Comments at 10; Iowa Telecomm. Ass'n (ITA) *Identical Support NPRM* Comments at 3-4; Independent Tel. and Telecomms. Alliance (ITTA) *Identical Support NPRM* Comments at 23-24; John Staurulakis, Inc. (JSI) *High-Cost Reform NPRMs* Comments at 3; Kansas Rural Indep. Tel. Companies *Identical Support NPRM* Comments at 4; Missouri PSC *Iden-*

Specifically, we require competitive ETCs to file cost information for the total costs of a service area, from which will be developed a cost per line. Spectrum costs are not included for purposes of calculating a cost per line.[148] We will then apply the same benchmarks that are applied to incumbent LECs' costs to determine whether the competitive ETCs qualify to receive high-cost support. In the case of a competitive ETC providing service in a non-rural service area, the cost per line would be compared to the benchmark threshold for support calculated by the High-Cost Proxy Model.[149] For a competitive ETC providing service in a rural service area, support will be determined by comparing the competitive ETC's cost per loop incurred to provide the supported services to the

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tical Support NPRM Comments at 5; Montana Telecomms. Ass'n *High-Cost Reform NPRMs* Comments at 12; NECA *High-Cost Reform NPRMs* Comments at 22-26; NTCA *High-Cost Reform NPRMs* Comments at 19-23; OPASTCO *High-Cost Reform NPRMs* Comments at 12-13; PetroCom License Corp. *Identical Support NPRM* Comments at 2-3; Qwest *High-Cost Reform NPRMs* Comments at 7; Rural Indep. Competitive Alliance (RICA) *High-Cost Reform NPRMs* Comments at 13-15; Rural Iowa Independent Tel. Ass'n (RIITA) *High-Cost Reform NPRMs* Comments at 2-3; Telcom Consulting Assoc., Inc. (TCA) *High-Cost Reform NPRMs* Comments at 13-15; Texas Statewide Tel. Coop., Inc. (Texas Statewide) *High-Cost Reform NPRMs* Comments at 10; Utah Rural Telecom Ass'n (URTA) *High-Cost Reform NPRMs* Comments at 8; WTA *High-Cost Reform NPRMs* Comments at 22-26.

[148] We agree with ITA that such costs do not represent a direct investment in facilities and infrastructure for purposes of providing supported services in high-cost areas. *See* ITA *Identical Support NPRM* Comments at 3 (spectrum costs represent investment in an intangible asset with an indefinite life rather than a direct investment in facilities with a limited useful life).

[149] *See* 47 C.F.R. § 54.309.

same national average cost per loop used to determine incumbent LEC support for the same service area.[150]

54. Because a competitive ETC may have few or no lines when it first receives its ETC designation, performing a calculation of per-line costs at the initial time of market entry likely would result in a considerable upward bias in the resulting amount. Similarly, a competitive ETC that has not gained customers in high-cost areas would have low line counts, skewing upward its costs per line. Conversely, a competitive ETC that has successfully gained customers will have lower costs per line due to the larger number of lines over which to spread its costs. To correct this issue, rather than relying on the competitive ETCs' line counts to determine per-line costs, we will use the same line counts used to determine the incumbent LEC cost per line for the same service area.

55. Consistent with the freeze on incumbent LEC high-cost support based on December 2008 support levels, we will use December 2008 as the base period for both the incumbent LEC lines used to determine the competitive ETCs' per-line costs, and for the benchmarks against which the competitive ETCs' costs will be compared for high-cost support purposes. Once the competitive ETC has demonstrated that its costs exceed the relevant benchmark, that competitive ETC will be entitled to continue to receive support for the relevant service area, frozen at the amount of support, on a lump sum basis, that the competitive ETC received in 2008. If a competitive ETC does not commit to the broadband build-out requirements set forth herein, or does not dem-

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[150] *See* 47 C.F.R. §§ 36.613, 36.622(c).

onstrate that its costs exceed the relevant benchmark, it shall no longer be entitled to receive support.

56. If no competitive ETC elects to show its own costs in a particular study area, we will conduct a reverse auction to award support to a broadband mobility provider. The reserve price for such auction shall be the largest amount of high-cost support received by a competitive ETC in the study area in 2008. There shall be no interim support in such study area to an existing competitive ETC that does not commit to the broadband requirements pending the completion of the reverse auction.[151]

6. Build-Out Milestones and Monitoring, Compliance, and Enforcement

57. We find that a rigorous monitoring, compliance and enforcement program is necessary to ensure that all ETCs receiving high-cost support adhere to their obligation to offer broadband Internet access service throughout their supported service areas by the end of their respective build-out periods. We therefore establish build-out requirements to monitor providers' progress toward their build-out commitment. Specifically, and as described in detail below, we require each provider receiving high-cost support to meet specific milestones with regard to broadband deployment in the years preceding completion.

58. *Applicability of Requirements.* As an initial matter, we find that the monitoring, compliance and en-

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[151] We also note that, consistent with our capping the high-cost fund and the provisions herein freezing both incumbent LEC and competitive ETC support at the study area level, we keep in place the interim cap on competitive ETC support adopted in the *Interim Cap Order*.

forcement requirements we adopt today will apply equally to all recipients of high-cost support that commit to offer broadband Internet access service as a condition of receiving support. Consumers should expect to receive the benefits of today's order, irrespective of whether an incumbent LEC, competitive ETC, or winning auction bidder receives high-cost support in their area. We find that the milestone obligations we impose today will not unduly burden any company; rather, they represent efforts we believe carriers would undertake in the normal course of constructing a broadband network. We therefore apply the monitoring, compliance, and enforcement requirements below to all recipients of high-cost support.

59. *Milestones for Committed Incumbent LECs and Existing Competitive ETCs.* To ensure that incumbent LECs that commit to offering broadband and competitive ETCs other than auction winners make steady progress towards offering broadband Internet access service throughout their entire service areas as required in this order, we adopt milestones based on customer locations where the incumbent LEC or competitive ETC is not yet offering broadband Internet access service (Unserved Customers).[152] Specifically, we require incumbent LECs and competitive ETCs to be capable of providing broadband Internet access service to an additional 20 percent of their Unserved Customers by the end of each year of the five-year build-out period. This requirement means that, of the total number of Unserved Customers in the service area, these carriers must offer broadband to 20 percent by the end of year one, 40 percent by the end of year two, 60 percent by the end of year three, 80 percent

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[152] Customer locations include both residential and business locations within the ETC's service area.

by the end of year four, and 100 percent by the end of year five. This five-year period starts from the due date of the incumbent LEC or competitive ETC commitment.

60. *Milestones for Auction Winners.* To ensure that auction winners make good progress toward meeting their obligation to become fully compliant with the requirements of this order, we require every auction winner to be capable of serving 10 percent of the potential customers in the service area by the end of year two, 25 percent by the end of year three, 50 percent by the end of year four, 65 percent by the end of year five, 75 percent by the end of year six, 85 percent by the end of year seven, 90 percent by the end of year eight, 95 percent by the end of year nine, 100 percent by the end of year ten. The absence of a milestone at the end of year one is intended to allow new service providers sufficient time to plan their network and to start deploying and marketing it within some parts of the service area. Similarly, the ascending milestones in the remaining years are intended to permit the auction winner a reasonable time in which to build its network and services while ensuring that it does not delay in reaching customers who need this vital service. The ten-year build-out period starts on the date on which that carrier wins the auction.

61. *Consequences of Not Meeting Milestones.* For all ETCs receiving high-cost support, failure to achieve any milestone will result in loss of eligibility for support (and, where this Commission has jurisdiction over the designation of ETC status, loss of ETC status) for that service area. If the ETC that loses its eligibility for support is an incumbent LEC or an auction winner, the study area will be subject to re-auction. If at the end of the build-out period, the ETC is not fully compliant with all its obligations under this order, including its obligation to offer

broadband Internet service throughout the service area, the ETC will forfeit its eligibility for support and, if its ETC designation was made by this Commission, lose its ETC status.

62. *Milestone Audits.* All milestone data will be subject to audit by the Commission's Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the build-out requirements, the Act, and Commission rules and orders.[153] Service providers will be required to comply fully with the Office of Inspector General's audit requirements, including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of the service providers and their employees, contractors, and other agents, in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this program.[154] Such audits or investigations may provide information showing that a service provider failed to comply with the Act or the Commission's rules, and thus

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[153] *See Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-Up, Changes to the Board of Directors for the National Exchange Carrier Association, Inc.*, WC Docket No. 03-109, Report and Order, 22 FCC Rcd 16372, 16383-84, para. 24 (*Comprehensive Review Report and Order*) (requiring "recipients of universal service support for high-cost providers to retain all records that they may require to demonstrate to auditors that the support they received was consistent with the Act and the Commission's rules, assuming that the audits are conducted within five years of disbursement of such support."). The term "service provider" includes any participating subcontractors.

[154] This includes presenting personnel to testify, under oath, at a deposition if requested by of the Office of Inspector General.

may reveal instances in which universal service support was improperly distributed or used.

63. We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the high-cost program and to determine on a case-by-case basis whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[155]

III. BROADBAND FOR LIFELINE/LINK UP CUSTOMERS

64. In this Part, pursuant to section 254(b) of the Act, we establish a Broadband Lifeline/Link Up Pilot Program (Pilot Program) to examine how the Lifeline and Link Up universal service support mechanism can be used to enhance access to broadband Internet access services for low-income Americans.[156] Specifically, we con-

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[155] *See, e.g.*, 41 U.S.C. §§ 51-58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

[156] The Commission has established a similar universal service pilot program under the Rural Health Care support mechanism. *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111 (2006) (*2006 Rural Health Care Pilot Program Order*) (establishing a Rural Health Care pilot program to examine how the Rural Health Care funding mechanism can be used to enhance public and non-profit health care providers' access to advanced telecommunications and information services); *Rural Heath Care Support Mechanism*, WC Docket No. 02-60, Order, 22 FCC Rcd 20,360 (2007) (selecting Rural Health Care pilot program participants eligible to receive up to 85% of the costs associated with the

clude that we will make available $300 million each year for the next three years to enable ETCs to support broadband Internet access service and the necessary access devices. In particular, if an ETC provides Lifeline service to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access installation, including a broadband Internet access device, up to a total amount of $100. In addition, if an ETC provides Lifeline service to an eligible household, the Pilot Program will double, up to an additional $10, the household's current monthly subsidy to offset the cost of broadband Internet access service.

A. Background

65. Since 1985, the Commission, pursuant to its general authority under sections 1, 4(i), 201, and 205 of the Act and in cooperation with state regulators and local telephone companies, has administered two programs designed to increase subscribership by reducing charges to low-income consumers.[157] The Commission's Lifeline program reduces qualifying consumers' monthly charges, and Link Up provides federal support to reduce eligible consumers' initial connection charges by up to one half.[158]

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construction of state or regional broadband health care networks and with the advanced telecommunications and information services provided over those networks).

[157] 47 U.S.C. §§ 151, 154(i), 201, 205.

[158] Lifeline currently provides low-income consumers with discounts of up to $10.00 off of the monthly cost of telephone service for a single telephone line in their principal residence, though this amount adjusts, in part, to reflect the carrier's tariffed federal subscriber line charge. *See* 47 C.F.R. § 54.403. Link Up provides low-income consumers with discounts of up to $30.00 off of the initial costs of installing telephone service. *See* 47 C.F.R. § 54.411(a). Under the Commission's rules, there are four tiers of federal Lifeline support. All eligible subscribers receive Tier 1 support which provides a dis-

66. Under the Commission's current rules, states and territories have the authority to establish their own Lifeline/Link Up programs that provide additional support to low-income consumers that incorporate the unique characteristics of each state or territory.[159] For example, in establishing eligibility criteria, states have the flexibility to consider federal and state-specific public assistance programs with high rates of participation among low-income consumers in the state. State certification procedures and outreach efforts can also take into account existing state laws and budgetary limits. Some states and territories, however, have elected to use the federal criteria as their default standard. These "federal default states" include not only states and territories with their own Lifeline/Link Up programs that have adopted the federal default criteria, but also states and territories that have not adopted their own Lifeline/Link Up program. In April 2004, the Commission released an order expanding the federal default eligibility criteria to in-

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count equal to the ETC's subscriber line charge. Tier 2 support provides an additional $1.75 per month in federal support, available if all relevant state regulatory authorities approve such a reduction. (All fifty states have approved this reduction.) Tier 3 of federal support provides one half of the subscriber's state Lifeline support, up to a maximum of $1.75. Only subscribers residing in a state that has established its own Lifeline/Link Up program may receive Tier 3 support, assuming that the ETC has all necessary approvals to pass on the full amount of this total support in discounts to subscribers. Tier 4 support provides eligible subscribers living on tribal lands up to an additional $25 per month towards reducing basic local service rates, but this discount cannot bring the subscriber's cost for basic local service to less than $1. *See* 47 C.F.R. § 54.403.

[159] *See* 47 C.F.R. §§ 54.409(a), 54.415(a).

clude an income-based criterion and additional means-tested programs.[160]

67. *Eligibility for Lifeline and Link Up.* In states that provide state Lifeline and Link Up support, Lifeline and Link Up are available to all subscribers who meet state eligibility requirements. Although states have some latitude in selecting means tests, state commissions must establish narrowly targeted qualification criteria that are based solely on income or factors directly related to income for low-income residents to be eligible for Lifeline and Link Up. In addition, states with eligible residents of tribal lands must ensure that their qualification criteria are reasonably designed to apply to residents of tribal lands, if applicable.[161] To receive Lifeline and Link Up in a state that does not mandate state Lifeline support, consumers must certify that their household income is at or below 135 percent of the Federal Poverty Guidelines, or that they participate in one of the following seven federal programs: Medicaid, Food Stamps, Supplemental Security Income (SSI), Federal Public Housing Assistance (Section 8), the Low-Income Home Energy Assistance Program (LIHEAP), the National School Lunch Program's free lunch program, or Temporary Assistance for Needy Families (TANF).[162] Subscribers living on tribal lands qualify to receive federal Lifeline support if: (1) they qualify under state criteria in a state that provides Lifeline support; (2) they certify that their household income is at or below 135 percent of the Federal Poverty Guidelines; (3) they certify that they

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[160] *See Lifeline and Link Up*, WC Docket No. 03-109, Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd 8302 (2004).

[161] 47 C.F.R. § 54.409(a).

[162] 47 C.F.R. § 54.409(b).

receive benefits from one of the seven federal programs listed above; or (4) they certify that they participate in one of the following additional federal assistance programs: Bureau of Indian Affairs General Assistance (GA), Tribally administered Temporary Assistance for Needy Families (Tribal TANF), or Head Start (meeting the income-qualifying standard).[163]

68. *TracFone and Computer and Communications Industry Association Petitions.* On October 9, 2008, TracFone Wireless, Inc. (TracFone) submitted a petition requesting that the Commission establish a trial basis program to support broadband Internet access service and the devices that support this service.[164] Citing data demonstrating that a significant amount of low-income families are unable to afford broadband Internet access, TracFone proposes that the Commission, on a temporary basis, provide affordable access to low-income consumers by supporting broadband Internet access service and the devices used to access these services.[165] TracFone proposes limiting the program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee, and the District of Columbia.[166] Doing so, according to Trac Fone, will enable to the Commission to examine how to better make available broadband Internet access service to low-income consumers throughout the Nation.[167]

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[163] 47 C.F.R. § 54.409(a)-(d).

[164] *See Lifeline and Link Up, Federal-State Joint Board on Universal Service*, WC Docket No. 03-109, CC Docket No. 96-45, Petition to Establish A Trial Broadband Lifeline/Link Up Program (filed Oct. 9, 2008) (*TracFone Petition*).

[165] *See TracFone Petition* at 3-4.

[166] *See TracFone Petition* at 3.

[167] *See TracFone Petition* at 5.

69. On October 7, 2008, the Computer and Communications Industry Association (CCIA) filed a petition requesting the Commission revise the definition of universal service supported services to allow low-income consumers receive support for broadband Internet access services.[168] CCIA states that, despite a critical need for broadband Internet access service, low-income consumers still have a considerably low broadband Internet access deployment rate. Accordingly, CCIA argues the definition of supported services for purposes of universal service should be revised to provide support for broadband Internet access service to low-income consumers.[169]

70. In recent proceedings, other parties have also urged the Commission to provide low-income consumers with support for broadband services. For example, Windstream argues that the Commission should direct broadband support to low-income consumers where such support is most needed.[170] AARP also concludes that the Commission should provide Lifeline/Link Up support for broadband services and urges the Commission to conduct a proceeding to examine the matter.[171] AARP proposes that in addition to examining supporting broadband services, the Commission should also examine how to in-

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[168] *See* Petition for Rulemaking to Enable Low-Income Consumers to Access Broadband Through the Universal Service Lifeline and Link Up Programs, WC Docket No. 03-109 (filed Oct. 7, 2008) (*CCIA Petition*).

[169] *See CCIA Petition* at 7.

[170] *See* Letter from Eric Einhorn, Vice President Governmental Affairs, Windstream Communications Inc., to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 99-68, 08-122, 05-337, 08-152 (Sept. 24, 2008) (Windstream Sept. 24, 2008 *Ex Parte* Letter).

[171] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

crease low-income consumers' access to devices that support broadband services and education on how to use such devices.[172] Many consumer groups and service providers have also commented in support of TracFone and CCIA's proposals to support the provision to low-income consumers of broadband Internet access service and the devices used to access these services.[173]

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[172] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

[173] *See, e.g.*, Letter from Dale R. Schmick, CEO, YourTel America, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 03-109, 05-337, at 2 (filed Oct. 21, 2008) (YourTel Oct. 21, 2008 *Ex Parte* Letter); Letter from Thomas J. Sugrue, Vice President Government Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket Nos. 04-356, 07-195 at 3 (filed Oct. 17, 2008) (urging the Commission to adopt quickly TracFone's and CCIA's proposals); Letter from Karyne Jones, President & CEO, National Caucus and Center on Black Aged, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 at 1 (filed Oct. 29, 2008) (NCBA Oct. 29, 2008 *Ex Parte* Letter); Letter from Donnie Ruby, Staff Associate, Telecommunications Research and Action Center, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008); Letter from Bill Newton, Executive Director, Florida Consumer Action Network, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 27, 2008); Letter from Robert D. Atkinson, Chair Public Policy Committee, Alliance for Public Technology, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 24, 2008) (APT Oct. 24, 2008 *Ex Parte* Letter); Letter from John Breyault, Vice President of Public Policy Telecommunications and Fraud, National Consumers League, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 23, 2008) (NCL Oct. 23, 2008 *Ex Parte* Letter); Letter from Mark Richert, Director, Public Policy, American Foundation for the Blind, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008) (AFB Oct. 28, 2008 *Ex Parte* Letter).

B. Discussion

71. Consistent with the Commission's authority under sections 1, 4(i), 201, 205, and 254 of the Act, we establish a Lifeline and Link Up pilot program to support the provision of broadband Internet access service and the devices used to access this service to low-income consumers.[174] In doing so, we explain the justification for establishing this program and provide criteria and obligations applicants must satisfy for selection to participate in this program. Further, we establish requirements for oversight and administration of the Pilot Program.

72. *Broadband Internet Access Service and Devices Eligible for Low Income Support.* In the *Universal Service First Report and Order*, consistent with its statutory obligations, the Commission maintained the authority to adopt changes to the Lifeline program to make it more consistent with Congress's mandates in the 1996 Act if

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[174] To the extent that our adoption of the Pilot Program adds broadband to the list of universal service supported services, we clarify that this inclusion is limited only to the Pilot Program—broadband is not a supported service for other low-income or high-cost support purposes. Pursuant to section 254(c)(1) of the Act, the Joint Board has recommended adding broadband as a supported service, and we do so for the limited purpose of the Pilot Program. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 4 ("The Joint Board now recommends that the nation's communications goals include achieving . . . universal availability of broadband Internet services"). Furthermore, the Commission's authority to provide universal service support to low-income consumers predates the adoption in 1996 of section 254 of the Act, and arises out of sections 1, 4(i), 201, and 205 of the Act. 47 U.S.C. §§ 151, 154, 201, 205; *Universal Service First Report and Order*, 12 FCC Rcd at 8956-57, paras. 338-40. Pursuant to our authority to regulate low-income support under these sections, as well as under section 254, we provide universal service support for broadband Internet access services through the Pilot Program.

such changes would serve the public interest.[175] We believe that a Lifeline and Link Up pilot program comports with the goals of universal service, and advances the public interest by providing new technologies and services to low-income consumers. Section 254(b)(2) of the Act instructs the Commission to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[176] Similarly, section 254(b)(3) states that "low-income consumers . . . should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[177]

73. Since the Commission first adopted its universal service rules in response to the 1996 Act, broadband Internet access service has evolved into a critical service for American consumers.[178] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and many other uses. Access to broadband Internet access service is especially important to low-income consumers for purposes of education, public health and public safety.[179] High-speed connections to

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[175] *Universal Service First Report and Order*, 12 FCC Rcd at 8956, para. 339.

[176] 47 U.S.C. § 254(b)(2) (emphasis added).

[177] *See* 47 U.S.C. § 254(b)(3) (emphasis added).

[178] *See* APT Oct. 24, 2008 *Ex Parte* Letter at 2; NCBA Oct. 29, 2008 *Ex Parte* Letter at 1; NCL Oct. 23, 2008 *Ex Parte* Letter at 1.

[179] According to the National Caucus and Center on Black Aged, older low-income Americans have difficulty affording broadband ser-

the Internet allow children in low-income families access to distance learning and research.[180] Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare to low-income families living in areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[181] Broadband Internet access service also enables the sharing of critical, time-sensitive information with first responders, government officials, and health care providers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis.

74. Despite the advances in broadband technology, broadband availability still lags for low-income consumers.[182] The Commission's most recent data reveal that where the median income is under $21,000, approximately 99.5 percent of households have high-speed service available with speeds in excess of 200 kbps in at least

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vices and many do not have Internet access. NCBA Oct. 29, 2008 *Ex Parte* Letter at 1 (citing Older Americans, Broadband and the Future of the Net, SeniorNet, 2008). Commenters also assert that broadband connections are particularly necessary for consumers who are blind, visually impaired, deaf or hard of hearing. *See* APT Oct. 24, 2008 *Ex Parte* Letter at 1 (citing ALLIANCE FOR PUBLIC TECHNOLOGY, ACHIEVING UNIVERSAL BROADBAND: POLICIES FOR STIMULATING DEPLOYMENT AND DEMAND 27 (2007)); AFB Oct. 28, 2008 *Ex Parte* Letter.

[180] *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, GN Docket No. 07-45, Notice of Inquiry, 22 FCC Rcd 7816, 7817, para. 3 (2007) (*706 Fifth NOI*).

[181] *See 2006 Rural Health Care Pilot Program Order*, 21 FCC Rcd at 11112, para. 5; *706 Fifth NOI*, 22 FCC Rcd at 7817, para. 4.

[182] *See* Cellular South *High-Cost Reform NPRMs* Comments at 10.

one direction.[183] Yet, according to the Pew Internet & American Life Project, only 25 percent of households with annual incomes below $20,000 have broadband service.[184] In contrast, among those living in households with annual incomes in excess of $100,000, broadband adoption is approximately 85 percent.[185]

75. According to the Commission's data, there are approximately 6.9 million consumers participating in the Lifeline universal service program.[186] Providing an additional $300 million in annual support through the low-income universal service support mechanisms over a three-year period should increase the broadband subscribership for low-income customers to over fifty percent.[187]

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[183] *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl. 19 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-277784A1.pdf.

[184] *See* 2008 PEW BROADBAND ADOPTION STUDY ii.

[185] *See* 2008 PEW BROADBAND ADOPTION STUDY at 2.

[186] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT.

[187] Desktop computers can be purchased for as low as $200. *See* Walmart Consumer Products, http://www.walmart.com/catalog/catalog.gsp?cat=3951&fromPageCatId=14503 (last visited Oct. 24, 2008). For $267, a consumer can purchase a new ASUS Eee PC 2G Surf laptop. *See* Amazon ASUS Eee PC 2G Surf Product Page, http://www.amazon.com/gp/product/B00114T9WY/ref=noref?ie=UTF8&s=pc (last visited Oct. 24, 2008). Personal computers and wireless devices will continue to become available at even lower rates. Throughout the world, there are $100 laptops and wireless devices. *See* Michael Trucano, InfoDev.org, Quick guide: Low-cost computing devices and initiatives for developing world (Apr. 2008), http://www.infodev.org/en/Publication.107.html (last visited Oct. 25, 2008). For example, Candlebox, being developed for use in India by Qualcom, is a low-cost, low-power device that uses mobile technology to provide wireless Internet access and supports e-mail, social networking, e-commerce and distance learning applications. RICHARD P. ADLER &

76. We therefore find that this Pilot Program furthers the universal service objectives of section 254 of the Act and serves the public interest by making this critical service available to the low-income Americans who cannot otherwise afford it. In addition, the Pilot Program will provide the Commission with a more complete and practical understanding of how to ensure the best use of Lifeline and Link Up universal service support to deploy advanced services to low-income consumers.[188]

1. Available Funding

77. We establish a maximum annual funding level for this broadband Lifeline and Link Up Pilot Program at $300 million for each of the next three years. In its petition, TracFone proposes that a pilot program should fund up to either $180 million or $360 million per year for Lifeline broadband Internet access service support, and up to $125 million or $250 million for the Link Up portion of the program, for a total of either $305 million or $610 million, depending on whether the program would support 500,000 participants or one million participants.[189]

78. While we recognize the importance of making sufficient funds available for this Pilot Program to enable us to determine whether and, if so, how to make broadband Internet access service funding a permanent part of the Lifeline and Link Up programs, we find that the levels of

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MAHESH UPPAL, ASPEN INSTITUTE INDIA, M-POWERING INDIA: MOBILE COMMUNICATIONS FOR INCLUSIVE GROWTH at 21 (2008), *available at* http://www.aspeninstitute.org/atf/cf/%7Bdeb6f227-659b-4ec8-8f84-8df23ca704f5%7D/2008INDIA.pdf.

[188] *See* NCBA Oct. 29, 2008 *Ex Parte* Letter at 2 (suggesting that the Pilot Program should be modeled after the existing Lifeline program and can be studied and evaluated to develop future broadband Lifeline/Link Up support programs).

[189] *See TracFone Petition* at 5.

funding proposed by TracFone are not sufficiently tied to a specific improvement in the adoption of broadband by Lifeline subscribers, as discussed above. In 2007, the overall size of the universal service fund's disbursement mechanisms was approximately $7.0 billion.[190] Of that amount, approximately $823 million went to fund the universal service low-income program.[191] TracFone's proposal represents a potential 74 percent increase over existing low-income program disbursements, and would be limited to targeting low-income consumers in only three states and the District of Columbia.[192] We are concerned that such a large funding commitment for a limited geographic area would not provide the Commission with sufficient information to assess the benefits of expanding the low-income support mechanisms upon the conclusion of the Pilot Program. When extrapolated to all states and territories, the low-income pilot program proposed by TracFone could potentially double the size of the $7 billion universal service fund.[193] We find it more appropriate to fund a pilot program that better correlates with providing broadband Internet access service to all eligible low-income support recipients as this provides better information regarding the permanent adoption of such support.

79. Instead, we set the size of the Lifeline and Link Up Pilot Program at up to $300 million per year over the next three years. We find that this amount provides benefits to low-income consumers while not overly in-

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[190] *See* USAC 2007 ANNUAL REPORT at 51. USAC's administrative expenses for 2007 were $104,073,000. *Id.* at 3.

[191] USAC 2007 ANNUAL REPORT at 3.

[192] *See TracFone Petition* at 3.

[193] Assuming $250 is provided to each consumer, the total cost of the TracFone proposal could reach almost $7 billion.

creasing the amount of low-income support disbursed from the universal service fund. Specifically, this level of funding should enable the program to increase the broadband subscribership for these customers to over fifty percent.[194]

2. Eligible Services and Equipment

80. For the broadband Lifeline/Link Up Pilot Program we adopt today, we limit support to one subsidy per household. For purposes of this order, we define "household" as one adult and his/her dependants, living together in the same residence.[195] Participating households who remain eligible for the program will be entitled to remain in the program beyond the first year, subject to the requirement that participating ETCs verify their customers' continued eligibility under the applicable income-based or program-based criteria, as they are required to do for their current voice Lifeline customers. We do not require state or carrier matching requirements. The Pilot Program is exempt from fees and taxes to the same degree as the current Lifeline programs.

81. Under the Link Up portion of the Pilot Program we adopt today, we seek to overcome barriers that low-income households might face in subscribing to broadband services, such as lacking the equipment necessary to connect to broadband services. Therefore, if an ETC currently provides or seeks to provide Lifeline voice ser-

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[194] *See supra* para. 75.

[195] *Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-up*, CC Docket Nos. 96-45, 02-6 and WC Docket Nos. 02-60, 03-109, Order, 20 FCC Rcd 16883, 16890, para. 12 (2005) (*Hurricane Katrina Order*). Also, service agreements of longer than the lesser of one year or the remaining Pilot Program funding period are prohibited.

vice to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access service installation, including a broadband Internet access device, up to a total amount of $100. The device can be a laptop computer, a desktop computer, or a handheld device, so long as the equipment has the capability to access the Internet at the speeds established per this order, and the equipment carries at least a warranty.[196] The device subsidy is a one-time subsidy and is limited to one unit per qualified household.[197] The subsidy amount will be paid by USAC to the participating ETC that provides the device and the service to the customer, utilizing the same process that USAC uses for the current Link Up program.[198]

82. Once low-income households have the ability to connect to the Internet, we seek to ensure that they can afford to subscribe to broadband Internet access service. Under the Lifeline portion of the program, if an ETC currently provides or seeks to provide Lifeline voice service to an eligible household, and that ETC provides broadband Internet access service, the Pilot Program will double the current monthly subsidy for the Lifeline subscriber up to $10 per month to offset the cost of broadband Internet access service.[199] As defined in this

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[196] Where such device costs $100 or less, the Pilot Program will support 90% of the cost of the broadband Internet access device.

[197] 47 C.F.R. § 54.411(b).

[198] *See* USAC, Low Income: Overview of the Process, http://www.universalservice.org/li/about/overview-process.aspx (last visited Oct. 11, 2008).

[199] Because $10 is the maximum federal support under Tier 1 to Tier 3 of the existing Lifeline program, we find this to be the appropriate support amount for purposes of the Pilot Program. *See* 2007 UNIVERSAL SERVICE MONITORING REPORT, tbl. 2.3. Ten dollars is also

order, broadband Internet access service is an "always on" service that combines computer processing, information provision, and computer interactivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed below.[200] This monthly support provided to participating customers under the Pilot Program is separate from and in addition to their monthly Lifeline support for voice telephone service.[201]

83. All ETCs participating in the existing low-income programs are eligible to participate, provided that they notify the Commission and USAC of their election to participate at least a month in advance and certify that they will comply with all program requirements, including those set forth herein. Such certification must identify the service area in which the ETC plans to offer such Lifeline/Link Up broadband services, the costs of such service and broadband device, and all costs, both recurring and nonrecurring, to the customer participating in the program. The ETC must offer the services supported in the Pilot Program throughout the entire service area. The Wireline Competition Bureau will release a public notice establishing a deadline by which ETCs must notify the Commission of their intention to participate.

84. The program we adopt today is technologically and competitively neutral; however, we establish minimum speeds at which participating ETCs must be able to

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above the average Lifeline support amount of $8.46, which includes both tribal and non-tribal recipients. *See id.*, tbl. 2.12.

[200] *See infra* para. 84.

[201] Pilot Program participants may not receive support for the same services from both the Pilot Program and the existing universal service programs—which consist of the rural health care, E-rate, high-cost, and low-income programs.

provide broadband service. ETCs participating in the Pilot Program must offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[202]

3. Selection Criteria

85. TracFone suggests that all ETCs notifying the Commission of their intent to participate in the Pilot Program should be allowed to provide the broadband Internet access service and devices under the Pilot Program.[203] TracFone also argues that the Commission should limit the Pilot Program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee and the District of Columbia.[204] We agree with TracFone that all ETCs should be allowed to provide services under the Pilot Program, but we disagree that the consumers who are eligible to participate should be limited to three states and the District of Columbia.[205] Instead, it is consistent with the public interest to allow all ETCs and consumers that meet the criteria discussed in this order to participate in the Pilot Program, limited only by the availability of funds. Support will be disbursed on a "first come, first served basis" where priority is established according to ETCs' submission of reimbursement requests to USAC and compliance with program eligibility.

86. *Consumer Qualifications.* To receive reimbursement under the Pilot Program, an ETC must provide support to a consumer eligible for support under the cur-

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[202] *See supra* para. 52.

[203] *TracFone Petition* at 4.

[204] *TracFone Petition* at 3.

[205] *See, e.g.*, YourTel Oct. 21, 2008 *Ex Parte* Letter at 2 (urging the Commission to allow low-income consumers living in Missouri to be eligible for Pilot Program support).

rent Lifeline and Link Up programs. Specifically, the consumer must meet the eligibility criteria specified in section 54.409 of the Commission's rules.[206] We agree with TracFone that only one connection and device per household should be funded. Accordingly, we limit Pilot Program support to one new connection and device per household. Lifeline consumers who currently have a broadband connection and related Internet device are excluded from participation in this Pilot Program. In addition to their obligations under section 54.409 of our rules, consumers must demonstrate that they do not currently have a broadband Internet access service subscription or broadband Internet access device.[207]

87. *ETC Obligation to Offer Pilot Program Services.* Prior to participation, ETCs must notify the Commission and USAC of their intention to participate. A participating ETC must offer the services and supported devices to all qualifying low-income consumers throughout its service areas. It must also follow the carrier obligations identified in section 54.405, as applicable, of the Commission's rules.[208] Consumers and ETCs must follow the framework and requirements of the existing Lifeline and Link Up program.[209]

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[206] *See* 47 C.F.R. § 54.409.

[207] As discussed above, for purposes of this Pilot Program we define "household" as one adult and his/her dependants living together in the same residence. *See supra* paras 80-84; *Hurricane Katrina Order*, 20 FCC Rcd at 16890, para. 12.

[208] *See* 47 C.F.R. § 54.405.

[209] 47 C.F.R. § 54.400-.417.

4. Implementation and Reporting Requirements

88. To be eligible for support, ETCs must submit a reimbursement request to USAC 30 days from the date a customer subscribes to service or purchases a device. We require participating each ETC to file with USAC on a monthly basis the number of Pilot Program consumers it is serving, the types and prices of devices offered, the type of technology used (including make and model of equipment used) and the speeds at which it is providing service to each of those consumers. ETCs in their monthly submission must also report the number of subscribers served for the past month and projections for the number of subscribers for the next 2 months. Such monthly reporting is required to allow USAC to monitor availability of funds under the Pilot Program and notify participating ETCs when funds may no longer be available for additional customers. In determining and/or projecting funds availability, USAC should consider the recurring costs of existing customers; we decline to specifically allocate the available funding between Lifeline and Link Up, relying instead on the certification and reporting requirements herein to enable USAC to properly administer the Pilot Program.

89. Similar to current recordkeeping requirements, we also require ETCs to maintain records to document compliance with all Commission requirements governing this Pilot Program for the three full preceding calendar years and provide that documentation to the Commission or USAC upon request.[219] Additionally, ETCs must maintain documentation for as long as the consumer is receiving broadband Lifeline service from that ETC pursuant

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[219] *See* 47 C.F.R. § 54.417(a).

to the Pilot Program, and for three additional years after the consumer stops receiving service pursuant to the Pilot Program.

90. ETCs may receive reimbursement for the revenue they forego in reducing the price of any qualified consumers' broadband Internet access service and related device. As a condition of participation, it is the ETC's responsibility to make available a wide array of cost efficient broadband Internet access devices capable of providing the speeds described above to qualified consumers under this program. ETCs must also comply with the self-certification procedures, and submit certifications with their monthly submissions, consistent with sections 54.410 and 54.416 of the Commission's rules.[211] Any services or equipment supported under this order are non-transferable and the devices must be returned to the ETC if they are not used in compliance with the terms of this order or other applicable laws or regulations. We delegate to the Wireline Competition Bureau the authority to disqualify an ETC or consumer from the Pilot Program and seek recovery of support not used in a manner consistent with this order.

5. Program Oversight

91. We are committed to guarding against waste, fraud, and abuse, and ensuring that funds disbursed through the Pilot Program are used for appropriate purposes. In particular, each Pilot Program participant shall be subject to audit by the Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the Pilot Program, Commission rules and orders, as well as section

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[211] *See* 47 C.F.R. §§ 54.410, 54.416.

254 of the Act.[212] The Pilot Program participant will be required to comply fully with the Office of Inspector General's audit requirements including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of itself and its employees, contractors, and other agents in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this Pilot Program.[213] Such audits or investigations may provide information showing that a Pilot Program participant or vendor failed to comply with the Act or the Commission rules, and thus may reveal instances in which Pilot Program awards were improperly distributed or used. To the extent the Commission finds that funds were distributed and/or used improperly, the Commission will require USAC to recover such funds though its normal processes, including adjustment of support amounts in other universal service programs from which Pilot Program participants receive support.[214] If any participant fails to comply with Commission rules or orders, or fails to timely submit filings required by such rules or orders, the Commission also has the authority to assess forfeitures for violations of such Commission rules and orders. In addition, any participant or service provider that willfully makes a false statement can be punished by

[212] *See* 47 C.F.R. § 54.619; *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 26.

[213] This includes presenting personnel to testify, under oath, at a deposition if requested by the Office of Inspector General.

[214] We intend that funds disbursed in violation of a Commission rule that implements section 254 or a substantive program goal will be recovered. Sanctions, including enforcement action, are appropriate in cases of waste, fraud, and abuse, but not in cases of clerical or ministerial errors. *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16388-89, para. 30.

fine or forfeiture under sections 502 and 503 of the Act,[215] or by fine or imprisonment under Title 18 of the United States Code (U.S.C.) including, but not limited to, criminal prosecution pursuant to section 1001 of Title 18 of the U.S.C.[216] We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the Pilot Program and to determine on a case-by-case basis whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[217] The Commission will also monitor the use of awarded monies and develop rules and processes as necessary to ensure that funds are used in a manner consistent with the goals of this Pilot Program. Finally, we remind participants that nothing in this order relieves them of their obligations to comply with other applicable federal laws and regulations.

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[215] 47 U.S.C. §§ 502, 503(b).

[216] 18 U.S.C. § 1001. Further, the Commission has found that "debarment of applicants, service providers, consultants, or others who have defrauded the USF is necessary to protect the integrity of the universal service programs." *Comprehensive Review Report and Order*, 22 FCC at 16390, para. 32. Therefore, the Commission intends to suspend and debar parties from the Pilot Program who are convicted of or held civilly liable for the commission or attempted commission of fraud and similar offenses arising out of their participation in the Pilot Program or other universal service programs. *See id.* paras. 31-32.

[217] *See, e.g.*, 41 U.S.C. §§ 51-58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

IV. REFORM OF UNIVERSAL SERVICE CONTRIBUTIONS

92. In this Part, we adopt a telephone numbers-based methodology under which contributors will pay a constant, flat-rate assessment based on the number of telephone numbers they have assigned to residential end users. We set this per-number assessment at the fixed rate of $1.00 per residential number per month. We conclude that providers of business services should contribute to the universal service fund on a connection basis, and we seek comment on implementation of that methodology. In the interim, providers of business services will continue to contribute based on interstate and international revenues for these services. The separate contribution methodologies for residential and business services will be implemented beginning on January 1, 2010.

A. Background

93. In implementing the universal service requirements of the 1996 Act, the Commission established a method for collecting funds to be disbursed through the various universal service support mechanisms. Specifically, the Commission determined that contributions to the universal service fund would be assessed on telecommunications providers based on their interstate and international end-user telecommunications revenues.[218] The Commission concluded that basing providers' uni-

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[218] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206-07, paras. 843-44; *Federal-State Joint Board on Universal Service; Access Charge Reform*, Sixteenth Order on Reconsideration and Eighth Report and Order in CC Docket No. 96-45 and Sixth Report and Order in CC Docket No. 96-262, 15 FCC Rcd 1679, 1685, para. 15 (1999) (*Fifth Circuit Remand Order*) (establishing a single contribution for all universal service support mechanisms based on interstate and international revenues).

versal service contributions on their revenues would be competitively neutral, easy to administer, and explicit.[219]

94. When the Commission adopted the revenue-based contribution system, assessable interstate revenues were growing. The total assessable revenue base has declined in recent years, however, from about $79.0 billion in 2000 to about $74.5 billion in 2006,[220] while universal service disbursements grew over that same time period from approximately $4.5 billion in 2000 to over $6.6 billion in 2006.[221] Declines in assessable contribution revenues combined with growth in universal service disbursements have increased the contribution factor applied to deter-

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[219] *Universal Service First Report and Order*, 12 FCC Rcd at 9206-08, 9211, paras. 843, 845-48, 854.

[220] *Compare* JIM LANDE & KENNETH LYNCH, FCC, 2000 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2002), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/telrev00.pdf *with* JIM LANDE & KENNETH LYNCH, FCC, 2006 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284929A1.pdf. *But see* Letter from David C. Bergmann, Chair, NASUCA Telecommunications Committee, to Chairman Kevin Martin et al., FCC, WC Docket Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Docket Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286, at 7 (filed Sept. 30, 2008) (NASUCA Sept. 30, 2008 *Ex Parte* Letter) (arguing that the growth in the contribution factor is "almost entirely" due to the growth in universal service disbursement requirements).

[221] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 1.2a (2001) (2001 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/mrs01-0.pdf; 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.11; *see also* USAC 2007 ANNUAL REPORT at 3, 51 (detailing universal service disbursements for 2007 at approximately $6.9 billion).

mine universal service contribution amounts.[222] This upward pressure jeopardizes the stability and sustainability of the support mechanisms, demonstrating the need for long-term fundamental reform of the contribution methodology.[223]

95. In addition, interstate end-user telecommunications service revenues are becoming increasingly difficult to identify as customers migrate to bundled packages of interstate and intrastate telecommunications and non-telecommunications products and services.[224] The integration of local and long-distance wireline services into packages that allow customers to purchase buckets of long distance minutes and local service for a single price blurs the distinction between revenue derived from intrastate telecommunications service and interstate tele-

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[222] The contribution factor grew from 5.9% in the first quarter of 2000 to 11.3% for the fourth quarter of 2008. *See Proposed First Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 15 FCC Rcd 3660 (WCB 1999); *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD Sept. 12, 2008) (*Fourth Quarter 2008 Contribution Factor Public Notice*).

[223] *See* 47 U.S.C. §§ 254(b), (d).

[224] Although the Commission has established safe harbors for the reporting of interstate telecommunications revenues derived from interstate telecommunications services bundled with customer premises equipment (CPE) or information services, it has not established guidelines for reporting interstate telecommunications service revenues for flat-rated bundles of wireline interstate and intrastate services. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review—Review of Customer Premises Equipment and Enhanced Local Exchange Markets*, CC Docket Nos. 96-61, 98-183, Report and Order, 16 FCC Rcd 7418, 7446-48, paras. 47-54 (2001) (*CPE Bundling Order*).

communications service. Similarly, the availability of mobile wireless calling plans that allow customers to purchase buckets of minutes on a nationwide network without incurring roaming or long-distance charges also makes it difficult for providers and the Commission to identify the amount of revenue derived from interstate telecommunications service.[225] Further, migration to interconnected VoIP services complicates the distinctions that serve as the basis for current contribution obligations.[226]

96. In 2001 and 2002, the Commission sought comment on modifications to the existing revenue-based contribution methodology, and on replacing that methodology with one that assesses contributions on the basis of a flat-fee charge, such as a per-line charge.[227] The Com-

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[225] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 21252, 21258-59, paras. 13-15 (1998) (*First Wireless Safe Harbor Order*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, 24965-67, paras. 21-25 (2002) (*Second Wireless Safe Harbor Order*).

[226] *See Universal Service Contribution Methodology*, WC Docket Nos. 06-122, 04-36, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518 (2006) (*2006 Interim Contribution Methodology Order*); *aff'd in part, vacated in part sub nom. Vonage Holdings Corp. v. FCC*, 489 F.3d 1232 (D.C. Cir. 2007).

[227] *See Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001) (*2001 Contribution NPRM*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Further Notice of Proposed Rulemaking and Report and Order, 17 FCC Rcd 3752, 3765, para. 31, 3766-89, paras. 34-83 (2002) (*Contribution First FNPRM*).

mission also sought comment on other universal service contribution methodologies, including moving to a numbers-based methodology.[228] Finally, in May 2008, the Commission encouraged commenters to refresh the record in several pending intercarrier compensation and universal service reform proceedings, including the contribution methodology proceeding.[229]

B. Discussion

97. The system of contributions to the universal service fund is broken. The Commission has repeatedly patched the current system to accommodate decreasing interstate revenues, a trend toward "all-you-can-eat" services that make distinguishing interstate from other revenues difficult if not impossible and changes in technology. While the service developments that precipitated these changes have enormous consumer benefits, they have also severely strained the contributions system.[230]

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[228] *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24983-97, paras. 66-100 (seeking comment on capacity-based proposals that had been developed in the record and on telephone-number proposals advocated by certain parties); *Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Public Notice, 18 FCC Rcd 3006 (2003) (*Contribution Staff Study*) (seeking comment on a Commission staff study that estimated potential contribution assessment levels under the then-newly modified revenue-based method and the three connection-based proposals in the further notice portion of the *Second Wireless Safe Harbor Order*).

[229] *Interim Cap Clears Path for Comprehensive Reform: Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

[230] We agree with commenters who argue that the contribution methodology requires a comprehensive overhaul. *See, e.g.*, Letter

We therefore adopt today a system of contributions that will assess a $1.00 contribution per residential telephone number per month, and we will move to a connections-based system for business services. In this part, we explain our legal authority to move to these new methodologies, why we have decided to move to these methodologies, and how the residential numbers-based system will work.

1. Legal Authority

98. The Commission has ample authority to require contributions from the variety of providers discussed below. The Commission's authority derives from several sections of the Act: section 254(d), Title I, and section 251(e). These sections of the statute provide us authority to require contributions from the kinds of service providers we address below in our discussions of the new numbers-based approach for residential services and the connections-based approach for business services.

99. Section 254 is the cornerstone of the Commission's universal service program. Section 254(d) first

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from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. 1 at 1 (filed Sept. 11, 2008) (AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter); Letter from Roger C. Sherman, Director, Government Affairs Wireless Regulatory, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 04-36 at 1 (filed June 14, 2006) (Sprint Nextel June 14, 2006 *Ex Parte* Letter); Letter from Susanne A. Guyer, Senior Vice President Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 06-122 at 2 (filed Oct. 28, 2008) (Verizon Oct. 29, 2008 *Ex Parte* Letter); Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96 45, WC Docket No. 06-122 at 1 (filed Oct. 20, 2008) (AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter).

provides that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[231] Under this "mandatory contribution" provision, every provider of telecommunications services[232] must contribute, although the Commission has authority to exempt a carrier or class of carriers if their contributions would be *de minimis*.[233]

100. Section 254(d) also provides that the Commission may require "[a]ny other provider of interstate telecommunications . . . to contribute to the preservation and advancement of universal service if the public interest so requires."[234] The Commission has relied on this "permissive authority" to require various providers of telecommunications,[235] but not necessarily telecommunications *services*,[236] to contribute. For example, the Commission has required entities that provide interstate telecommunications to others on a private contractual basis to con-

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[231] 47 U.S.C. § 254(d).

[232] Section 254(d) refers to "telecommunications carriers," which are defined as "any provider of telecommunications services." 47 U.S.C. § 153(44).

[233] 47 U.S.C. § 254(d).

[234] 47 U.S.C. § 254(d).

[235] "Telecommunications" is defined as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43).

[236] "Telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46).

tribute to the universal service fund,[237] as well as payphone aggregators.[238] Most recently, we required interconnected VoIP providers to contribute even though the Commission has not determined that they are telecommunications carriers. Specifically, in the *2006 Interim Contribution Methodology Order*, we used our permissive authority under section 254(d) to require interconnected VoIP providers to contribute, and we noted that they "provide" telecommunications to their end users.[239] We also noted that in some cases, the interconnected VoIP provider may be "providing" telecommunications even if it arranges for the end user to have PSTN access through a third party.[240]

101. The Commission also has authority under Title I to require other service providers to contribute. In gen-

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[237] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9183-84, paras. 794-95. We note that private service providers that provide interstate connections solely to meet their internal needs (i.e., self-providers) will not be required to contribute under the new methodology. This is consistent with our current policy. In the *Universal Service First Report and Order*, the Commission reasoned that, for self-providers of interstate telecommunications, the telecommunications is incidental to their primary non-telecommunications business. *See Universal Service First Report and Order*, 12 FCC Rcd at 9185, para. 799.

[238] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9184-85, paras. 796-98. *But see* Letter from Robert F. Aldrich, Counsel for the American Public Communications Council (APCC), to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 01-92, Attach. (filed Oct. 23, 2008).

[239] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7538-40, paras. 39-41; 47 C.F.R. § 54.706(a).

[240] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41 ("To provide this capability [telecommunications], interconnected VoIP providers may rely on their own facilities or provide access to the PSTN through others.").

eral, the Commission can rely on its ancillary jurisdiction under Title I when the Commission has subject matter jurisdiction over the service to be regulated, and the assertion of jurisdiction is "reasonably ancillary to the effective performance of [its] various responsibilities."[241] The Commission relied on this authority before section 254 was added by the 1996 Act to establish a high-cost support fund,[242] which the U.S. Court of Appeals for the D.C. Circuit found to be a permissive exercise of Title I authority.[243] And more recently in the *2006 Interim Contribution Methodology Order*, the Commission relied on its ancillary jurisdiction under Title I as an additional source of authority to require contributions from interconnected VoIP providers.[244] In that order, the Commission noted that the Act grants subject matter jurisdiction over interconnected VoIP because it involves "transmission" of voice by wire or radio,[245] and that imposing contribution obligations on interconnected VoIP providers was "reasonably ancillary" to the effective perform-

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[241] *See United States v. Southwestern Cable Co.*, 392 U.S. 157, 177-78 (1968); *United States v. Midwest Video Corp.*, 406 U.S. 649, 667-68 (1972); *FCC v. Midwest Video Corp.*, 440 U.S. 689, 700 (1979); *see also American Library Ass'n v. FCC*, 406 F.3d 689 (D.C. Cir. 2005).

[242] *See Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Decision and Order, 96 F.C.C.2d 781, (1984), *aff'd sub nom. Rural Tel. Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988).

[243] *Rural Tel. Coalition*, 838 F.2d at 1315.

[244] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7541-43, paras. 46-49.

[245] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 47 & n.160 (citing *IP-Enabled* Services, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245 (2005) (*VoIP 911 Order*), *aff'd sub nom. Nuvio Corp. v. FCC*, 473 F.3d 302 (D.C. Cir. 2006); 47 U.S.C. § 152(a)).

ance of the Commission's responsibilities to establish "specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service."[246] In particular, the Commission noted that interconnected VoIP providers "benefit from their interconnection to the PSTN."[247]

102. In addition, Congress provided the Commission with "plenary authority" over numbering in section 251(e). Specifically, the Commission has "exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States."[248] The Commission relied on its authority under section 251(e) to support its action to require interconnected VoIP providers to provide E911 services.[249] The Commission noted that it exercised its authority under section 251(e) because, among other reasons, "interconnected VoIP providers use NANP numbers to provide their services."[250]

103. These sections of the Act provide the Commission ample authority to require contributions from all providers subject to the new numbers-based and connections-based approaches described in more detail below. These methodologies may require some providers to contribute directly to universal service when in the past they may have been contributing only indirectly or not at all. For example, under the numbers-based approach, any provider who assigns an "Assessable Number" to a residential user must contribute $1.00 per number per

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[246] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48 (quoting 47 U.S.C. § 254(d)).

[247] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48.

[248] 47 U.S.C. § 251(e)(1).

[249] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

[250] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

month.[251] Providers such as VoIP providers who are not "interconnected VoIP" providers, electronic facsimile service providers, Internet-based TRS providers, one-way and two-way paging service providers, and telematics providers may assign Assessable Numbers to residential users and maintain the retail relationship with the end users.[252] Not all of these providers are "telecommunications carriers" subject to the mandatory contribution obligation of section 254(d). Nonetheless, we have authority to require them to contribute. First, all of these providers provide—directly or indirectly—some amount of interconnection to the public switched telephone network (PSTN), the network that universal service supports. Interconnection to the PSTN benefits the consumers of each of these types of services, facilitating communication (even if just one-way communication) between the end user and PSTN users. As we noted in the *2006 Interim Contribution Methodology Order*, interconnected VoIP providers often provide access to the PSTN via third parties[253] and this is sufficient to permit the Commission to rely on its authority to require contributions from "other provider[s] of interstate telecommunications."[254] And as we explain below, it is in the public interest (as required by section 254(d)) that these providers contribute. Furthermore, the prerequisites for the use of our Title I ancillary jurisdiction are unquestiona-

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[251] The term Assessable Number is defined below. *See infra* paras. 115-129.

[252] This list is meant to be illustrative, not exhaustive. Other providers may also have to contribute to the universal service fund based on the criteria described in this order.

[253] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41.

[254] 47 U.S.C. § 254(d).

bly met here. All the services that rely on assignment of an Assessable Number to a residential end user come within the Commission's broad subject matter jurisdiction because they involve in some manner "interstate . . . communication by wire or radio."[255] And similar to our explanation in the *2006 Interim Contribution Methodology Order*, requiring contributions from providers who take advantage of PSTN connectivity whether directly or indirectly makes sense because their end users benefit from the ubiquity of that network and from being somehow interconnected with it.[256] Finally, our plenary authority over numbering supports our actions here with regard to a numbers-based methodology for residential services. The purpose of a uniform system of numbering is to facilitate communication on interconnected networks based on a standardized system of identifiers—telephone numbers.[257] Those customers who are assigned telephone

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[255] 47 U.S.C. § 152(a); *see also VoIP 911 Order*, 20 FCC Rcd 10261-62, para. 28 (providing detailed explanation of why interconnected VoIP falls within the Commission's subject matter jurisdiction).

[256] *Compare 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7540, para. 43.

[257] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Second Report and Order and Memorandum Opinion and Order, 11 FCC Rcd 19392, 19404, 19407, paras. 19, 25 (1996) (noting that numbering administration ensures the creation of a nationwide, uniform system of numbering essential to the efficient delivery of interstate and international telecommunications services and the development of a competitive telecommunications services market) (subsequent history omitted); *see also Administration of the North American Numbering Plan*, CC Docket No. 95-283, Report and Order, 11 FCC Rcd 2588, 2591, para. 4 (1995) ("Adequate telephone numbers, available through a uniform numbering plan, are essential to provide consumers efficient access to new telecommunications services and technologies and to support continued growth of an economy increasingly dependent upon those services and technologies."); *Administration of the North*

numbers, whether for plain old telephone service (POTS) or for any other service, are using the numbers to take advantage of some feature of the PSTN, whether it is the capability to be called, to have their locations automatically relayed to emergency call handlers, to be faxed from anywhere, or for some other reason. Because customers are receiving this benefit, it is appropriate that their service providers (and ultimately, likely, the customers themselves) contribute to the ubiquity and support of the network from which they are benefiting.

104. We reject suggestions that we do not have authority to require contributions based on numbers or connections because we lack authority over intrastate services.[258] The same number or connection typically is used for both interstate and intrastate services. The Commission and courts have rejected the assertion that simply because a single facility has the capacity to provide both interstate and intrastate services, the Commission lacks authority to regulate any aspect of the facility.[259] In fact, the subscriber line charge (SLC) that the Commission established is intended to capture the *inter-*

American Numbering Plan, CC Docket No. 92-237, Notice of Proposed Rulemaking, 11 FCC Rcd 2068, para. 2 (1994).

[258] *See, e.g.*, American Association of Paging Carriers (AAPC) *Contribution First FNPRM* Comments at 7; Alaska Communication Systems (ACS) *Contribution First FNPRM* Reply at 6-7; Allied Personal Communications Industry Association of California (Allied) *Contribution First FNPRM* Comments at 6-7; National ALEC Association/Prepaid Communications Association (NALA/PCA) *Contribution First FNPRM* Reply at 3.

[259] *See, e.g.*, *NARUC v. FCC*, 737 F.2d 1095, 1113 (D.C. Cir. 1984) ("The same loop that connects a telephone subscriber to the local exchange necessarily connects that subscriber into the interstate network as well.").

state cost of the *local* loop.[260] The contribution methodologies we adopt are thus limited to assessments on services that can provide interstate service. We will only require providers to contribute to universal service based on the Assessable Numbers or connections that are capable of originating or terminating interstate or international communications.[261]

2. The New Numbers-Based Assessment Methodology for Residential Services

105. As discussed above, we adopt a new contribution methodology for residential services based on assessing telephone numbers, rather than interstate and international services revenue. We find that this change will benefit contributors and end users by simplifying the contribution process and providing predictability as to the amount of universal service contributions and pass-through charges for residential services. For residential services, we set the contribution amount at a flat $1.00 per month charge for each number associated with residential services.

a. Benefits of a Numbers-Based Contribution Methodology

106. We find that adoption of a telephone number-based methodology for residential services will help preserve and advance universal service by ensuring a specific, predictable, and sufficient funding source, consistent with the universal service principles of section 254(b) of the Act.[262] Changes in technology and services have

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[260] *NARUC v. FCC*, 737 F.2d at 1113-14.

[261] Services that provide only intrastate communications and do not traverse a public interstate network will not be required to contribute under the new assessment methodology.

[262] 47 U.S.C. § 254(b)(5).

made the revenue-based contribution mechanism difficult to administer. As commenters have noted, the distinction between intrastate and interstate revenues is blurring as providers move from their traditional roles as pure LECs or interexchange carriers (IXCs) to businesses that offer consumers the choice of purchasing their telecommunications needs from a single source.[263] Additionally, these providers are offering consumers greater flexibility, such as bundling of local and long distance service at a flat rate.[264] Moreover, technologies such as wireless and interconnected VoIP have emerged that provide voice and data services that know no jurisdictional boundaries.[265] Consumers benefit from the opportunity to obtain bundled services, and the universal service contribution mechanism should reflect and complement those marketplace and technological developments as much as possible. Our decision to use numbers as the basis for assessing contributions for residential services will enhance the specificity and predictability of entities' contributions.

107. Our adoption of a numbers-based contribution methodology will benefit both residential consumers and

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[263] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1.

[264] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Nov. 19, 2007) (Ad Hoc Nov. 19, 2007 *Ex Parte* Letter) (discussing the convergence of different applications for business and residential customers onto a single integrated network with bundled pricing).

[265] *See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, 22412-14, paras. 16-18 (2004) (*Vonage Order*), *aff'd sub nom. Minnesota Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir. 2007).

contributors by simplifying the basis for assessments and stabilizing assessments at a set amount of $1.00 per month per residential telephone number.[266] Contributors are allowed, and in most cases do, recover their universal service contribution costs from fees assessed on their end-user customers.[267] Under the revenue-based contribution mechanism, a provider's contribution costs fluctuated from quarter to quarter, causing consumers' universal service fees to fluctuate as well. These fluctuations did not allow customers to anticipate changes to their fees. A set $1.00-per-number contribution assessment is simple and predictable for both contributors and for consumers. To the extent a contributor elects to recover its contribution costs through end-user fees, its residential customers will pay the same $1.00 fee per number each month, making the assessment simple and predictable.[268]

108. A numbers-based contribution methodology also benefits residential end users because it is technologically and competitively neutral. A consumer will pay the same universal service charge regardless of whether the consumer receives residential service from a cable pro-

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[266] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2.

[267] Contributors are prohibited from passing through to subscribers more than their contribution cost. 47 C.F.R. § 54.712.

[268] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also* Information Technology Industry Council (ITI) *2006 Contribution FNPRM* Comments at 6; NCTA *2006 Contribution FNPRM* Comments at 5; Small Business Administration Office of Advocacy (SBA) *2006 Contribution FNPRM* Comments at 8; Vonage *2006 Contribution FNPRM* Comments at 7-8; Letter from Gregory V. Haledjian, Regulatory and Governmental Relations, Counsel to IDT Corporation and USF By the Numbers Coalition, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, Attach. at 3-4 (filed Jan. 30, 2007).

vider, an interconnected VoIP provider, a wireless provider, or a wireline provider. This will enable residential consumers to choose the providers and provider types they want without regard to any artificial distortions that would otherwise be caused by differing contribution charges.[269] In a marketplace characterized by increased competition within and between different technology platforms, residential consumers will receive the same universal service charge regardless of the type of service the customer chooses.

109. Similarly, by subjecting contributors to the same regulatory framework for assessments on residential services regardless of technology, the numbers-based methodology will eliminate incentives under the current revenue-based system for providers to migrate to services and technologies that are either exempt from contribution obligations or are subject to safe harbors.[270] The elimination of such incentives will result in a more competitively and technologically neutral marketplace and a more predictable source of funding for the universal service mechanisms.

110. The adoption of a fixed $1.00 per residential number per month contribution assessment is specific and predictable and will simplify the administration of universal service contributions.[271] Interstate end-user

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[269] *See, e.g.*, NCTA *2006 Contribution FNPRM* Comments at 5; Vonage *2006 Contribution FNPRM* Comments at 6; Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, 01-92, CC Docket Nos. 96-45, 99-68, 96-262 at 2 (filed July 15, 2008).

[270] *See* AT&T *2006 Contribution FNPRM* Comments at 4.

[271] In addition to being easily administrable, the record supports adoption of $1.00 per month as the residential per-number assessment amount. *See, e.g.*, Letter from James S. Blaszak, Counsel for

telecommunications revenues have become increasingly difficult to identify, particularly for residential services, due to increased bundling of local and long distance service and the growth of consumer interconnected VoIP offerings.[272] In contrast, telephone numbers provide an easily identifiable basis for contribution.[273] The amount of North American Numbering Plan (NANP) telephone numbers in use has shown steady, stable growth, providing a fairly constant basis for estimating universal service support amounts.[274] The new methodology, based on a flat $1.00 per residential number per month, will be eas-

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Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, Attach. at 3 (filed Oct. 25, 2005); *see* Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 3 (filed Sept. 23, 2008) (AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter) (estimating a $1.01 per-number per-month assessment under a numbers-based contribution methodology); *see also* Letter from Paul Garnett, Assistant Vice President, CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45 at 1 (filed Oct. 2, 2008) (CTIA Oct. 2, 2008 *Ex Parte* Letter), Attach. at 5 (supporting the AT&T and Verizon proposal); Letter from David B. Cohen, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. at 1 (filed Sept. 25, 2008).

[272] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.1.

[273] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* ALEXANDER BELINFANTE, FCC, TELEPHONE SUBSCRIBERSHIP IN THE UNITED STATES, tbl. 1 (2008), *available at* http://hraunfoss.fcc.gov/edocs_lic/attachmatch/DOC284923A1.pdf.

[274] *See* CRAIG STROUP AND JOHN VU, FCC, NUMBERING RESOURCE UTILIZATION IN THE UNITED STATES, tbl. 12 (2008) (showing number utilization from December 2000 to December 2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284926A1.pdf.

ier to administer, facilitating greater regulatory compliance. A numbers-based contribution methodology will also be readily applicable to emerging service offerings. The new methodology minimizes the potential for providers to avoid contributions by bundling intrastate revenues with interstate revenues or engaging in other bypass activities.[275]

111. Further, assessing universal service contributions based on residential telephone numbers will promote number conservation.[276] Telephone numbers are a finite, public resource. If contributors are assessed based on the residential telephone numbers assigned to them, they will have an incentive to efficiently manage their numbering resources in a manner that minimizes their costs. We expect that this will result in the need for fewer area code splits or overlays due to number exhaust.[277]

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[275] *See* Ad Hoc *Contribution First FNPRM* Comments at 6-7; Coalition for Sustainable Universal Service (CoSUS) *Contribution First FNPRM* Comments at 38; Sprint *Contribution First FNPRM* Comments at 8 9. Because residential services will no longer be assessed based on revenues, contributors may not mark-up or otherwise adjust the $1.00 per Assessable Number per month residential contribution assessment in response to uncollectible revenues.

[276] *See, e.g.*, ITI *2006 Contribution FNPRM* Comments at 6; Vonage *2006 Contribution FNPRM* Comments at 7.

[277] *See Numbering Resource Optimization*, CC Docket No. 99-200, Report and Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 7574, 7625, para. 122 (2000) (*NRO I Order*) (determining that implementation of thousands-block number pooling is essential to extending the life of the NANP by making the assignment and use of NXX codes more efficient); *see also Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Fourth Report and Order, 18 FCC Rcd 12472, 12474, para. 5 (2003) (*NRO IV Order*) (explaining further that thousands-block number pooling is a numbering resource optimization measure in which 10,000 numbers in an

112. Our adoption of a numbers-based contribution methodology for residential services is consistent with the goal of ensuring just, reasonable, and affordable rates.[278] The per-number assessment of $1.00 per number per month will represent a reduction in pass-through charges for many residential customers.[279] Although the $1.00 per number per month assessment may represent an increase in universal service charges for residential customers that make few or no long distance calls, this increase should be slight. Under the current revenue-based contribution mechanism, providers may assess a federal universal service fee on the basis of the customer's SLC. The residential SLC may be as high as $6.50 per month.[280] Based on the most recent contribution factor of 11.4 percent, even a customer who made no long distance calls could thus be assessed $0.74 per month in universal service charges under the existing revenue-based methodology.[281] Thus, the potential in-

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NXX are divided into ten sequential blocks of 1,000 numbers and allocated to different service providers (or different switches) within a rate center).

[278] 47 U.S.C. § 254(b)(1).

[279] *See* Letter from Jean L. Kiddoo and Tamar E. Finn, Counsel to IDT Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Aug. 2, 2007) (IDT Aug. 2, 2007 *Ex Parte* Letter) (showing that the average residential household paid about $1.37 in universal service fees in 2006). IDT claims the data show that the lowest-income consumers paid an average of $1.09 in universal service fees for wireline telephone bills. *Id.* at 6.

[280] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1). The SLC is referred to as the End User Common Line Charge in the Commission's rules.

[281] The revenue from the $6.50 SLC would be multiplied by the 11.4% contribution factor, resulting in a contribution amount and corresponding assessment of $0.74. *See Fourth Quarter 2008 Contribution Factor Public Notice* at 1; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 3.

crease for a customer who makes no long distance calls could be as little as $0.26 per month under the $1.00 per number methodology. In addition, we have separate protections to ensure that telephone service remains affordable for low-income subscribers.[282]

113. Some commenters assert that assessing a flat universal service charge is inherently unfair because it does not take into account the fact that some people make many interstate and international calls, while others make few if any such calls in a given month.[283] We disagree. We find that imposition of a flat charge is warranted because all contributors and their subscribers receive a benefit from being connected to the public network, enabling them to make and receive interstate calls.[284] The *ability* to make or receive interstate calls over a public network is a significant benefit and it is reasonable to assess universal service contributions for residential customers based on access to the network. Customers who do not make any interstate calls still receive the benefit of accessing the network to *receive* interstate calls. The $1.00 per month per number assessment reflects our finding that it is equitable for providers to contribute a fixed amount based on the ability to access and utilize a ubiquitous public network.

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[282] *See* 47 C.F.R. § 54.400 *et seq.*; *infra* para. 141 (describing contribution exemptions for services to low-income consumers).

[283] *See, e.g.*, Letter from Maureen A. Thompson, Executive Director, Keep USF Fair Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 5-7 (filed Mar. 27, 2006) (Keep USF Fair Mar. 27, 2006 *Ex Parte* Letter); *see also* NASUCA Sept. 30, 2008 *Ex Parte* Letter at 9.

[284] *Universal Service First Report and Order*, 12 FCC Rcd at 8783, para. 8

114. Some commenters allege that changing from the current revenue-based methodology to a new mechanism based on telephone numbers would not be equitable because it could reduce contributions from certain industry segments and increase them for others.[285] Although the change to a numbers-based contribution methodology for residential services will result in changes in the relative contribution obligations of industry segments, the new contribution methodology is not inequitable or discriminatory. The evolving nature of the telecommunications marketplace and of its participants requires the Commission to periodically review and revise the contribution methodology to ensure that providers continue to be assessed on an equitable and non-discriminatory basis. We find that, given the difficulties in continuing to assess contributions entirely on a revenue-based methodology and the benefit to residential consumers of access to the public network, it is equitable to adopt a numbers-based contribution methodology that assesses a $1.00 per month per number fee for residential services.

b. Assessable Numbers

115. Below, we describe the telephone numbers for which service providers are obligated to contribute to the universal service fund. We call these "Assessable Numbers." The Commission has addressed certain reporting based on telephone numbers in other contexts. In the number utilization context, the Commission requires that each telecommunications carrier that receives numbering resources from the North American Numbering Plan

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[285] *See, e.g.*, FW&A *Contribution First FNPRM* Comments at 13-15; NRTA and OPASTCO *Contribution First FNPRM* Comments at 7-11; SBC *Contribution First FNPRM* Comments at 18; Verizon *Contribution First FNPRM* Reply at 6; Verizon Wireless *Contribution First FNPRM* Comments at 5-6.

Administrator (NANPA), the Pooling Administrator, or another telecommunications carrier report its numbering resources in each of six defined categories of numbers set forth in section 52.15(f) of our rules.[286] In the regulatory

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[286] These six categories of numbers are defined as follows:

(i) Administrative numbers are numbers used by telecommunications carriers to perform internal administrative or operational functions necessary to maintain reasonable quality of service standards.

(ii) Aging numbers are disconnected numbers that are not available for assignment to another end user or customer for a specified period of time. Numbers previously assigned to residential customers may be aged for no more than 90 days. Numbers previously assigned to business customers may be aged for no more than 365 days.

(iii) Assigned numbers are numbers working in the Public Switched Telephone Network under an agreement such as a contract or tariff at the request of specific end users or customers for their use, or numbers not yet working but having a customer service order pending. Numbers that are not yet working and have a service order pending for more than five days shall not be classified as assigned numbers.

(iv) Available numbers are numbers that are available for assignment to subscriber access lines, or their equivalents, within a switching entity or point of interconnection and are not classified as assigned, intermediate, administrative, aging, or reserved.

(v) Intermediate numbers are numbers that are made available for use by another telecommunications carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer. Numbers ported for the purpose of transferring an established customer's service to another service provider shall not be classified as intermediate numbers.

(vi) Reserved numbers are numbers that are held by service providers at the request of specific end users or customers for their future use. Numbers held for specific end users or customers for more than 180 days shall not be classified as reserved numbers.

47 C.F.R. § 52.15(f)

fee context, the Commission used the category of "assigned numbers" as the starting point for determining how to assess fees on certain providers, but found it necessary to modify that definition to account for the different regulatory contexts. Specifically, in assessing regulatory fees for commercial mobile radio service (CMRS) providers that report number utilization to NANPA based on the reported assigned number count in their Numbering Resource Utilization and Forecast (NRUF) data, the Commission requires these providers to adjust their assigned number count to account for number porting. The Commission found that adjusting the NRUF data to account for porting was necessary for the data to be sufficiently accurate and reliable for purposes of regulatory fee assessment.[287]

116. We adopt a new term based on the category of assigned numbers to represent the numbers being assessed for universal service contribution purposes—"Assessable Numbers." The definition of Assessable Numbers that we adopt focuses on those numbers that are actually in use by end users for services that traverse a public interstate network. Specifically, we define an Assessable Number as a NANP telephone number or functional equivalent identifier[288] in a public or private

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[287] *See Assessment and Collection of Regulatory Fees for Fiscal Year 2005, Assessment and Collection of Regulatory Fees for Fiscal Year 2004*, MD Dockets No. 05-59, 04-73, Report and Order and Order on Reconsideration, 20 FCC Rcd 12259, 12271, paras. 39-40 (2005).

[288] "Functional equivalent identifier" means an identifier used in place of and with the same PSTN access capability as a NANP number; it is not intended to capture identifiers used in conjunction with NANP numbers, such as internal extensions that cannot be directly dialed from the PSTN. Nor is "functional equivalent identifier" intended to capture routing identifiers used for routing of Internet

network that is in use by a residential end user and that enables the residential end user to receive communications from or terminate communications to (1) an interstate public telecommunications network or (2) a network that traverses (in any manner) an interstate public telecommunications network.[289] Assessable Numbers include geographic as well as non-geographic telephone numbers (such as toll-free numbers and 500-NXX numbers) so long as they meet the other criteria described in this part for Assessable Numbers.

117. The provider with the retail relationship to the residential end user is the entity responsible for contributing.[290] We impose the contribution obligation on the provider with the retail relationship to the end user for several reasons. First, this provider will have the most accurate and up-to-date information about how many Assessable Numbers it currently has assigned to end users.

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traffic, unless such identifiers are used in place of a NANP number to provide the ability to make or receive calls on the PSTN.

[289] For purposes of the definition of Assessable Numbers, we include only the NANP telephone numbers used in the United States and its Territories and possessions.

[290] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844; *see also, e.g.*, Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 7 (filed Sept. 24, 2008) (Qwest Sept. 24, 2008 *Ex Parte* Letter); AT&T and Verizon Sept. 11, 2008, *Ex Parte* Letter, Attach. 1 at 1-2; Letter from Brad E. Mutschelknaus, Counsel for XO Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 04-36, Attach. at 9 (filed Oct. 3, 2008); Letter from Donna N. Lampert, Counsel for Google, to Marlene H. Dortch, Secretary, FCC (filed Oct. 3, 2008) (Google Oct. 3, 2008 *Ex Parte* Letter); *see also* 47 C.F.R. § 54.5 (defining "contributor" as "an entity required to contribute to the universal service support mechanism pursuant to § 54.706 [of the Commission's rules]").

Second, this provider is also in the best position to distinguish residential users from business users, and thus to determine how many of its telephone numbers in use are Assessable Numbers. Finally, this provider, and its users, are benefiting from a supported PSTN, and thus it is sound policy to require them to contribute to its support.[251] We note that today, providers are permitted to pass through their contribution assessments to end users, and we understand that they typically do so.[252] Under the new methodologies, they may continue to do so, subject to the same requirement that they will not pass through more than their contribution amount.[253]

118. Next, we specify whether certain types of numbers are included in the definition of Assessable Numbers. First, numbers used for intermittent or cyclical purposes are included in the definition of Assessable Numbers. Numbers used for cyclical purposes are numbers designated for use that are typically "working" or in use by the end user for regular intervals of time. These numbers include, for example, an end user's summer home telephone number that is in service for six months out of the year.[254] In the *NRO III Order*, the Commission clarified that these types of numbers should generally be categorized as "assigned" numbers if they meet certain

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[251] *See supra* para. 103 (discussing the public interest in requiring these entities to support the network).

[252] *See, e.g.*, AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24978, para. 50.

[253] 47 C.F.R. § 54.712.

[254] *See Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Third Report and Order and Second Order on Reconsideration in CC Docket No. 96-98 and CC Docket No. 99-200, 17 FCC Rcd 252, 303, para. 119 (2001) (*NRO III Order*).

thresholds and that, if they do not meet these thresholds, they "must be made available for use by other customers" (i.e., they are "available" numbers).[275] Because these numbers are assigned to end users, we find they should be included in the definition of Assessable Numbers we adopt today.

119. We exclude from our definition of Assessable Numbers those telephone numbers that satisfy the section 52.15 definition of "assigned numbers" solely because the "numbers [are] not yet working but hav[e] a customer service order pending" for five days or less.[276] Providers generally do not bill for services that have yet to be provisioned and therefore are not compensated for services during the pendency of the service order. Moreover, such numbers are not yet operational to send or receive calls. Thus, under the existing contribution methodology, providers would not contribute for services they are about to provide (but have not yet provided) under a pending service order. We continue to find it appropriate for contributors not to be required to contribute to the universal service fund for pending service orders.

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[275] *NRO III Order*, 17 FCC Rcd at 394, para. 122 ("With this requirement, we seek to limit the amount of numbers that are set aside for use by a particular customer, but are not being used to provide service on a regular basis. Thus, in order to categorize such blocks of numbers as assigned numbers, carriers may have to decrease the amount [of] numbers set aside for a particular customer. We also clarify that numbers 'working' periodically for regular intervals of time, such as numbers assigned to summer homes or student residences, may be categorized as assigned numbers, to the extent that they are 'working' for a minimum of 90 days during each calendar year in which they are assigned to a particular customer. Any numbers used for intermittent or cyclical purposes that do not meet these requirements may not be categorized as assigned numbers, and must be made available for use by other customers.").

[276] *See* 47 C.F.R. § 52.15(f)(iii).

120. We exclude from the definition of Assessable Numbers those telephone numbers that telecommunications providers have transferred or ported to a carrier using resale or the unbundled network element platform. Under prior numbering orders, such telephone numbers would still be included in the NRUF assigned number count of the transferring-out carrier.[297] Consistent with our definition of Assessable Numbers, because the underlying provider no longer maintains the retail relationship with the end user, the provider should not include these numbers in its Assessable Number count. Conversely, the receiving provider of such transferred customers would include the associated telephone numbers in their count of Assessable Numbers.

121. We exclude from the definition of Assessable Numbers those numbers that meet the definition of an Available Number, an Administrative Number, an Aging Number, or an Intermediate Number as those terms are defined in section 52.15(f) of the Commission's rules.[298] For a particular carrier, the carrier will not have an end user associated with a number in any of these categories of numbers. For example, an intermediate number is a number that is "made available for use by another telecommunications carrier or non-carrier entity for the pur-

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[297] *NRO I Order*, 15 FCC Rcd at 7586-87, para. 18. Ported-out numbers, a subcategory of assigned numbers, are not reported to NANPA although NRUF reporting carriers are required to maintain internal records associated with these numbers for five years. *Id.* at 7592, 7601, paras. 36, 62.

[298] *See* 47 C.F.R. § 52.15(f); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 7 (arguing, among other things, that numbers used for administrative purposes and numbers that are not "actively" working, such as aging, unassigned, reserved numbers, and numbers donated back to the industry pool should be excluded from the contributor's base).

pose of providing telecommunications service to an end user or customer."[299] The receiving provider will be responsible for including the number as an Assessable Number once it provides the number to an end user.[300]

122. We exclude non-working telephone numbers from the definition of Assessable Number. Carriers report as assigned numbers for NRUF purposes entire codes or blocks of numbers dedicated to specific end-user customers if at least fifty percent of the numbers in the code or block are working in the PSTN.[301] Consistent with our definition of Assessable Numbers, carriers should not include the non-working numbers in these blocks in their Assessable Number counts, because the non-working numbers portion of these blocks are not providing service to the end user.

123. We exclude from the definition of Assessable Number those numbers that are used merely for routing purposes in a network, so long as such numbers are always—without exception—provided without charge to the end user, are used for routing only to Assessable Numbers for which a universal service contribution has been paid, and the ratio of such routing numbers to Assessable Numbers is no greater than 1:1. For example, a NANP number used solely to route or forward calls to a

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[299] *See* 47 C.F.R. § 52.15(f)(v).

[300] *See NRO I Order*, 15 FCC Rcd at 7587, para. 21 (2000) ("We agree with commenters who opine that [intermediate] numbers should not be categorized as *assigned* numbers because they have not been assigned to an end user. . . . We therefore conclude that numbers that are made available for use by another carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer should be categorized as *intermediate* [numbers].").

[301] *NRO III Order*, 17 FCC Rcd at 304, para. 122.

residential number, office number, and/or mobile number would be excluded from our definition of Assessable Number if such routing number were provided for free, and such number routes calls only to Assessable Numbers. If, however, such routing or forwarding is provided for a fee, such as with remote call forward service or foreign exchange service, both the routing number and the end user number to which calls are routed or forwarded would be considered Assessable Numbers.

124. In addition, incumbent LECs need not include numbers assigned to wireless providers that interconnect at the end office of an incumbent LEC and have obtained numbers directly from the incumbent LEC.[302] Because the incumbent LEC does not have the retail relationship with the end user, it should not include these numbers in its Assessable Number count. The wireless carriers that have the retail relationship with the end users must include these telephone numbers in their Assessable Number count.

125. Finally, we exclude from the definition of Assessable Numbers those numbers associated with Lifeline services for the reasons described below.[303]

126. We do not restrict our definition to numbers that exclusively use the PSTN.[304] As noted above, evolution in

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[302] When a wireless carrier interconnects at an incumbent LEC end office it is known as a Type 1 interconnection. *See Federal Communications Commission Seeks Comment on Initial Regulatory Flexibility Analysis in Telephone Number Portability Proceeding*, CC Docket No. 95-116, Public Notice, 20 FCC Rcd 8616, 8632, App. B at para. 19 n.53 (2005) ("Type 1 numbers reside in an end office of a LEC and are assigned to a Type 1 interconnection group, which connects the wireless carrier's switch and the LEC's end office switch.").

[303] *See infra* paras. 140-46.

communications technology away from the PSTN to alternative networks that may only partially (if at all) traverse the PSTN is one of the causes in the erosion of the contribution base under the current revenue-based methodology. As more service providers migrate to alternative networks that partially access the PSTN, continuing to assess universal service contributions based only on traffic that exclusively traverses the PSTN will not account for this migration; nor will it allow us to meet our principle of competitive neutrality.[305] Moreover, if a service provider connects a private network to a public network, the service provider and its customers benefit from the connection to the PSTN. Because universal service supports the PSTN and these parties connect to the PSTN, they benefit from universal service.[306] Thus, it is increasingly important that we conform our regulatory definitions to recognize this reality. Indeed, the Commission has already begun to recognize the need to create a level regulatory playing field. For example, calls to end users that utilize interconnected VoIP service are not wholly within the PSTN. Indeed, calls between two interconnected VoIP users may not touch the PSTN at all.

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[304] The record is split over whether the definition of an assessable number should be restricted to the PSTN. AT&T and Verizon, for example, do not include such a requirement in their proposed definitions. *See* AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 1. Other commenters, however, argue for such a requirement. *See* Google Oct. 3, 2008 *Ex Parte* Letter at 1 (the definition of an assessable number should be "premised on a telephone number acting as a proxy for an underlying two-way PSTN connection"). As we explain herein, such a restriction is not warranted.

[305] *Universal Service First Report and Order*, 12 FCC Rcd at 9207, paras. 845-46.

[306] *Universal Service First Report and Order*, 12 FCC Rcd at 9184 para. 796.

Yet we found in 2006 that interconnected VoIP providers must contribute to the universal service fund.[307] For these reasons, we conclude that our definition must account for public or private interstate networks, regardless of the technology of the network (e.g., circuit-switched, packet-switched) or the transmission medium of the network (e.g., wireline, wireless).

127. Finally, we recognize that, by declining to adopt for contribution purposes verbatim the definition of "assigned numbers" in section 52.15(f) of our rules, which is used by carriers to file NRUF reports,[308] we may nominally increase some of the administrative burden associated with universal service contribution filings. We find, however, that any minor administrative cost increases arising from not using the preexisting definition are outweighed by the benefits of modifying the definition to achieve sound universal service policy. For example, as stated above, the existing definition of assigned numbers would not enable us to meet our universal service contribution goal of ensuring that the provider with the retail relationship to the end user be the one responsible for contributing.[309]

128. Under our numbers-based approach, certain providers will be required to contribute to the universal service fund based on Assessable Numbers even though they are not today required to submit NRUF data. Section 52.15(f) of the Commission's rules requires only "reporting carriers" to submit NRUF data to the NANPA.[310]

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[307] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7536-37, paras. 33-34.

[308] *See* 47 C.F.R. § 52.15(f)(iii).

[309] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844.

[310] 47 C.F.R. § 52.15(f).

A "reporting carrier" is defined as a telecommunications carrier that receives numbering resources from the NANPA, the Pooling Administrator, or another telecommunications carrier.[311] In the case of numbers provided by a telecommunications carrier to a non-carrier entity, the carrier providing the numbers to such entities must report NRUF data to the NANPA for those numbers. Thus, non-carrier entities that use telephone numbers in a manner that meets our definition of Assessable Numbers do not report NRUF data yet must contribute.[312] For example, interconnected VoIP providers may use telephone numbers that meet our definition of Assessable Numbers even though these providers do not report NRUF data.[313] These non-carrier entities that use numbers in a manner that meets our definition of Assessable Number will be required to determine their Assessable Number count based on their internal records (e.g., billing system records) and will be required to report such numbers to USAC.[314]

129. We are mindful that our move to a numbers-based contribution methodology may encourage entities to try to avoid their contribution obligations by develop-

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[311] 47 C.F.R. § 52.15(f)(2).

[312] *NRO I Order*, 15 FCC Rcd at 7587, para. 21.

[313] *See Administration of the North American Numbering Plan*, Order, 20 FCC Rcd 2957, 2961-62, para. 9 (2005) (*SBCIS Waiver Order*) (noting that most VoIP providers' numbering utilization data are embedded in the NRUF data of the LEC). In the *SBCIS Waiver Order*, the Commission granted SBCIS, an Internet service provider, permission to obtain numbering resources directly from the NANPA and/or Pooling Administrator, conditioned on, among other things, SBCIS reporting NRUF data. *Id.* at 2959, para. 4.

[314] *See infra* paras. 147-53.

ing ways to bypass the use of NANPA-issued numbers.[315] To the extent, however, these alternative methods are the functional equivalent of numbers and otherwise meet our definition of Assessable Numbers, such entities must report these functional equivalents as Assessable Numbers to the universal service fund administrator.

3. Contribution Assessment Methodology for Business Services

130. Although we find that a numbers-based contribution mechanism is superior to the existing revenue-based mechanism for residential services, applying a numbers-based approach to business services would result in inequitable contribution obligations. Specifically, certain business services that do not utilize numbers, or that utilize them to a lesser extent, would not be contributing to the universal service fund on an equitable basis.[316] Section 254(d) of the Act requires "every carrier"

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[315] *See* Letter from Jeanine Poltronieri, Vice President, Federal Regulatory, BellSouth D.C., Inc, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed July 6, 2005) ("If voice service is provided without using telephone numbers, but with IP address or other identifier, FCC will need to establish a 'functional equivalency' test.").

[316] Business services such as private line and special access services do not typically utilize telephone numbers in the same manner as residential services, and would not contribute equitably to the universal service fund under a numbers-based approach. *See, e.g.*, Letter from James S. Blaszak, Counsel to Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 3 (filed Oct. 9, 2002); Letter from Robert Quinn, Vice President Federal Government Affairs, AT&T, to Marlene Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 2 (filed Oct. 22, 2002). Moreover, unlike residential services, which usually have one telephone number assigned per access line, business services do

that provides interstate telecommunications services to contribute to the universal service fund.[317] Thus, providers of business services, including non-numbers based services, must continue to contribute. We conclude that these services should be assessed based on their connection to the public network.

131. A number of commenters supported moving to a methodology that would assess telephone numbers for those services that are associated with a telephone number and assess based on capacity of the connection to the public switched network those services not associated with a telephone number.[318] Other commenters supported retaining a revenue-based methodology for these services.[319] As discussed above, a revenue-based contribution methodology is no longer sustainable in today's

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not usually have a number of telephone numbers assigned that aligns with the number of access lines utilized.

[317] 47 U.S.C. § 254(d). Therefore, we disagree with those parties that continue to support a numbers-only based approach because we find such an approach would be inconsistent with the statutory requirement that every telecommunications carrier must contribute to the universal service fund. *See, e.g.*, Letter from James S. Blaszak, Counsel for Ad Hoc, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 07-135, Attach. at 5 (filed Oct. 14, 2008).

[318] *See Staff Study*; *see also* Ad Hoc Telecommunications Users Committee 2003 Staff Study Reply; Letter from John Nakahata, Counsel for the Coalition for Sustainable Universal Service, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Oct. 31, 2002).

[319] *See* Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 6 (filed Mar. 21, 2006) (Qwest Mar. 21, 2006 *Ex Parte* Letter); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 2.

telecommunications marketplace.[320] Additionally, a connections-based contribution methodology will provide a basis for assessing services not associated with telephone numbers, and will recognize the greater utility derived by business end users from these high capacity business service offerings.[321] Further, in contrast to the revenues on which contributions are currently based, the number and capacity of connections continues to grow over time, providing a contribution base that is more stable than the current revenue-based methodology. Moreover, a connections-based mechanism can be easily applied to all business services. We, therefore, conclude that a connections-based contribution mechanism is the better option for business services. We seek comment below on the implementation of the connections-based contribution mechanism for business services.[322]

132. We find that it is equitable and nondiscriminatory, consistent with the requirements of section 254(d) of the Act, to establish different contribution methodologies for residential and business services.[323] Although the statute states that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service," it does not require that all contributors or all services be assessed in the same

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[320] *See supra* para. 97.

[321] Time Warner *2006 Contribution FNPRM* Comments at 2.

[322] We decline at this time to adopt AT&T and Verizon's proposal for assessing contributions on connections based on flat rate charges that would differ based on the speed of the connection. AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 2. Instead, we seek further comment on implementing assessments based on connections.

[323] 47 U.S.C. § 254(d).

manner.[324] Under the current revenue-based mechanism, the Commission has established different contribution methodologies through the use of proxies for wireless and interconnected VoIP services.[325] As noted above, continuing to use a revenues-based contribution methodology has become increasingly complex, and a numbers-based system would avoid many of those complexities.[326] At the same time, however, if we relied exclusively on a numbers-based contribution methodology, there are some business services—such as private line and special access—that would escape contribution requirements entirely. That result would be inconsistent with the obligation that all providers of interstate telecommunications services contribute to universal service, and would impose an unfair burden on providers that contribute on the basis of numbers.[327] We therefore conclude that adopting different contribution assessment methodologies for residential and business services will result in equitable and nondiscriminatory contribution obligations.

133. On an interim basis, while we conduct a proceeding to implement the connections-based contribution methodology, we continue to require providers to con-

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[324] 47 U.S.C. § 254(b)(4).

[325] The proxies offer an alternative to contributions assessed on actual interstate revenues; they are intended to approximate the portion of revenues derived from the provision of interstate telecommunications services. *First Wireless Safe Harbor Order*, 13 FCC Rcd at 21258-60, paras. 13-15 (establishing safe harbors for wireless service providers); *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 14954, para. 1 (modifying the wireless safe harbors); *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7532, 7545, paras. 23, 53 (revising the wireless safe harbor and establishing a safe harbor for interconnected VoIP providers).

[326] *See supra* para. 95.

[327] 47 U.S.C. §§ 254(b)(4), (d).

tribute to the universal service fund using the current revenue-based methodology for their business services.[328] We find that providers of business services should continue to bear their portion of the universal service contribution obligation to ensure the sufficiency of the fund while the connections-based contribution mechanism is being implemented.[329]

134. During the interim period in which the revenue-based contribution assessment for business services remains in place, the contribution factor for providers of

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[328] Contributors will base their contributions on business service revenues in the same manner as they do currently. We make no change to the *de minimis* exemption or to the Limited International Revenue Exception (LIRE) for business contributions based on revenues. 47 U.S.C. § 254(d); 47 C.F.R. § 54.708; *Fifth Circuit Remand Order*, 15 FCC Rcd at 1687-88, para. 19; *Contribution First FNPRM*, 17 FCC Rcd at 3806-07, paras. 125-28. These exceptions do not apply to residential contributions based on numbers.

[329] *See* 47 U.S.C. § 254(d). Prepaid calling card providers, as well as any other current contributors who provide services to residential consumers but do not assign Assessable Numbers, shall continue to contribute based on their revenues during the interim period until these business services are assessed on the basis of connections and/or numbers. Despite IDT's recent request that its prepaid calling card services be treated as residential for purposes of universal service contribution assessments, we find that, consistent with arguments made over the years by such providers, these calling card services are provided to businesses. *See* Request for Review of Decision of the Universal Service Administrator by IDT Corporation and IDT Telecom, CC Docket No. 96-45 at 3 (filed June 30, 2008) ("The vast majority of [prepaid calling card sales] are completed through a network of distributors and resellers before being purchased by the ultimate end user consumer."). *But see* Letter from Tamar E. Finn, Counsel, IDT Corporation, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 (filed Oct. 28, 2008) (asking the Commission to treat prepaid calling cards as residential services if the Commission adopts a numbers-based methodology limited to residential numbers).

business services will be determined based on the funding requirements not covered by the $1.00 assessment on Assessable Numbers. We will hold constant the contribution assessment on Assessable Numbers and determine the revenue contribution factor based on the quarterly projected demand of the universal service mechanisms divided by the quarterly projected-collected interstate and international end user telecommunications revenues from business services in the same manner in which the current contribution factor is calculated.[330] This approach will ensure a specific, predictable, and sufficient funding source for the Commission's universal service mechanisms.

4. Wireless Prepaid Plans

135. We adopt an alternative methodology for telephone numbers assigned to handsets under a wireless prepaid plan. Some commenters assess prepaid wireless services on a per-minute-of-use basis.[331] For example, prepaid wireless providers argue that their customers are typically low-income or low-volume consumers and, as such, should be subject to a lesser assessment.[332] Verizon and TracFone further assert that prepaid wireless providers may have difficulty administering a per-

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[330] The Commission may revise the specific per-number residential assessment amount in the future, if market conditions warrant.

[331] AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 4.

[332] Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed Sept. 17, 2008) (TracFone Sept. 17, 2008 *Ex Parte* Letter); CTIA *2006 Contribution FNPRM* Comments at 6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 3-4; Letter from John M. Beahn and Malcolm Tuesley, Counsel to Virgin Mobile USA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 4 7 (filed June 12, 2006) (Virgin Mobile June 12, 2006 *Ex Parte* Letter).

number assessment.[333] Verizon, therefore, recommends that any new contribution methodology accommodate prepaid wireless service providers by adopting a per-number assessment that "reflects the unique characteristics of [the] service," and TracFone similarly agrees.[334] Finally, CTIA essentially argues that the sheer number of prepaid wireless end users—over 44 million—combined with the likelihood that most of these end users would see a rise in their pass-through assessments warrants an exception.[335]

136. To accommodate the unique situation of prepaid wireless service providers, we find it appropriate to create a limited modification in contribution assessments for providers of prepaid wireless services and their end users.[336] We agree with commenters that it is considerably more difficult for wireless prepaid providers to pass-through their contribution assessments in light of their "pay-as-you-go" service offerings.[337] Because of this sig-

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[333] *See, e.g.*, Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 2; Virgin Mobile June 12, 2006 *Ex Parte* Letter, Attach. at 7.

[334] *See* Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach.; *see also* Letter from Antoinette Bush, Counsel for Virgin Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 11 (filed Mar. 18, 2005) (Virgin Mobile Mar. 18, 2005 *Ex Parte* Letter); AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter at 6.

[335] *See* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1 (raising a concern that current proposals could harm the large number of prepaid wireless customers).

[336] As discussed below, Lifeline customers are exempt from contribution assessments. *See infra* para. 141.

[337] *See* Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 3 (filed June 15, 2007) (TracFone June 15 *Ex Parte* Letter).

nificant practical issue, we will modify the numbers-based assessment for prepaid wireless providers with regard to their offering of these services. Further, we note that, just as with Lifeline customers, many prepaid wireless end users are low income consumers. For example, TracFone states that about half of its customers have incomes of $25,000 or less.[358]

137. We find that TracFone's "USF by the Minute" proposal best addresses the concerns of prepaid wireless providers within the context of the new numbers-based contribution methodology we adopt today.[359] TracFone's proposed USF by the Minute Plan would calculate universal service contribution assessments on prepaid wireless services by dividing the residential per-number assessment (the $1.00 flat fee adopted above) by the number of minutes used by the average postpaid wireless customer in a month. This per-minute number would then be multiplied by the number of monthly prepaid minutes generated by the provider. This amount would be the provider's monthly universal service contribution obligation. The per minute assessment, however, would

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[358] TracFone June 15, 2007 *Ex Parte* Letter at 3. TracFone also asserts that an exception is warranted because it provides service to low volume end users (i.e., end users that do make a small amount of calls, measured in minutes). *Id.* However, as explained below, we decline to provide a contribution exception for low-volume users. *See infra* para. 143.

[359] AT&T and Verizon support the TracFone discount approach for prepaid wireless providers. AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 3; *see also* Letter from David L. Sieradzki, Counsel to OnStar Corp., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (dated Oct. 28, 2008) (OnStar "strongly supports" the TracFone per minute of use proposal for prepaid wireless services) (OnStar Oct. 28, 2008 *Ex Parte* Letter).

be capped at an amount equal to the current per month contribution per Assessable Number, the per-number assessment amount adopted above.[340] We illustrate the proposal below.

138. According to CTIA data submitted by TracFone, the average wireless postpaid customer used 826 minutes per month for the period ending December 2007.[341] The residential per-number assessment of $1.00 would be divided by 826 minutes to calculate a per-minute assessment of $0.001210654. The wireless prepaid provider's contribution obligation would be calculated by multiplying the per-minute assessment by the number of prepaid minutes generated for the month. If the wireless prepaid provider generated a billion prepaid minutes in a month, its contribution for that month would be $1,210,654.[342] If the prepaid provider had 10 million prepaid customers that month, the average contribution per customer would be $0.12 and its contribution obligation would remain at $1,210,654. If, on the other hand, it had only 1 million customers, the average contribution per-customer would be $1.20, which exceeds the residential per-number assessment of $1.00. In this case, because the per-customer contribution amount under the calculation would exceed the residential per-number assessment established by the Commission, the prepaid provider's contribution obligation would be capped at $1,000,000, which is the residential per-number assessment of $1.00 multiplied by the

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[340] TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 4-5.

[341] *See* TracFone Sept. 17, 2008 *Ex Parte* Letter at 5. We use these data because they are the most recent publicly available data.

[342] To the extent that the prepaid wireless subscriber is a Lifeline customer for the prepaid service, the prepaid provider should exclude prepaid minutes associated with the qualifying Lifeline customer. *See infra* para. 141.

1 million monthly prepaid customers. Under this scenario, the average per-customer contribution for the prepaid wireless provider would be equal to the per-number contribution of $1.00 for non-prepaid residential numbers.

139. We find the TracFone discount approach superior to other forms of a discount proposed by parties. For example, CTIA proposed a fifty percent discount for prepaid wireless providers.[343] The TracFone approach is based on actual wireless calling data, whereas the CTIA approach represents a more arbitrary half-off discount. Moreover, the CTIA proposal makes no allowance for the type of end user that is using the prepaid wireless service. This contrasts with the TracFone proposal, which would not provide any discount to those end users that use more than the average monthly post-paid number of minutes. As explained above, for those customers whose usage would result in more than the $1.00 pass-through, the assessment on the provider and the pass-through would be capped at $1.00 per month per Assessable Number. Thus, high volume users would neither benefit from, nor be penalized by, the discount mechanism. Finally, we make clear that if the prepaid provider is an ETC and is providing service to qualifying Lifeline customers, the provider is exempt from contribution assessments on the qualifying Lifeline customers and we prohibit the provider from assessing any universal service pass-through charges on their Lifeline customers.

5. Exceptions to Contribution Obligations

140. A number of parties have asked for exceptions from the contribution obligation. We find that, in general, providing an exception or exemption to a particular

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[343] CTIA Oct. 2, 2008 *Ex Parte* Letter at 5.

provider or to a particular category of end users would complicate the administration of the numbers-based methodology we adopt today. The result would unfairly favor certain groups by reducing or eliminating their contribution obligations, while increasing the contribution obligations on providers that are not exempted from contributing. Therefore, we conclude that grant of an exemption from the contribution obligations is only warranted for those who are truly unable to bear the burden of contributing to the universal service fund—low-income consumers. As discussed below, we exempt providers from contribution assessments on their qualifying Lifeline program customers and prohibit contributors from assessing any universal service pass-through charges on their Lifeline customers. Similarly, we exempt providers of stand-alone voice mail services, which are provided to low-income "phoneless" people, from contribution obligations. As explained below, an exception for low-income consumers is consistent with the Commission's policies underlying the low-income universal service program and targets universal service benefits to those consumers most in need of those benefits.[344]

141. We conclude that telephone numbers assigned to Lifeline customers should be excluded from the universal service contribution base and providers of Lifeline service may not pass-through contribution assessments to Lifeline customers.[345] The Lifeline program provides an opportunity for the Commission to ensure that low-income families are not denied access to telephone service. We find that an exception for Lifeline customers

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[344] *Alenco v. FCC*, 201 F.3d at 621.

[345] *See, e.g.*, AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 4 (proposing that numbers assigned to Lifeline customers be excluded from the monthly number count for contribution purposes).

satisfies the high threshold necessary to justify an exception to the new numbers-based contribution methodology we adopt today. Lifeline customers are, by definition, among the poorest individuals in the country. As such, they are in the greatest need of relief from regulatory assessments. Prohibiting recovery of universal service contributions from Lifeline customers helps to increase subscribership by reducing qualifying low-income consumers' monthly basic local service charges.[346] The record, moreover, overwhelmingly supports the creation of an exception for Lifeline customers. Consumer groups, large telecommunications customers, LECs, and wireless providers all support creating an exemption for Lifeline customers, and no commenter opposes an exemption for Lifeline customers.[347] We therefore adopt an exemption to our numbers-based contribution methodology for Lifeline customers.

142. Similarly, we find that stand-alone voice mail service providers are exempt from direct contribution obligations of the new methodology we adopt today. Community Voice Mail National (CVM) argues that stand-alone voice mail services consist of free voice mail access to "phoneless" people.[348] As in the exemption for

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[346] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24982, para. 62.

[347] *See, e.g.*, CTIA *2006 Contribution FNPRM* Comments at 5; CU et al. *High-Cost Reform NPRMs* Reply at 58; Ad Hoc Nov. 19, 2007 *Ex Parte* Letter at 4; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 5.

[348] Letter from Jennifer D. Brandon, Executive Director, Community Voice Mail National, to Tom Navin, Wireline Competition Bureau, FCC, CC Docket No. 96-45 at 1 (filed May 30, 2006) (Community Voice Mail May 30, 2006 *Ex Parte* Letter) (CVM provides "free, personalized voicemail access to people in crisis and transition

Lifeline customers, we find that stand-alone voice mail service of the type provided by CVM benefits low-income consumers who are most in need of access to such services. We therefore exempt providers of this type of stand-alone voice mail service from universal service contribution assessments on numbers associated with stand-alone voice mail services, and we prohibit providers of these services from assessing any universal service contribution pass-through charges on customers of these services.[349]

143. Although commenters have sought contribution exceptions for other groups of consumers or service providers, we decline to adopt any further exceptions.[350] Some parties argue that consumers who make few or no calls, i.e., low-volume users, should be exempt from the numbers-based residential contribution assessment

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(homeless, victims of domestic violence, and other 'phoneless' people")).

[349] We decline to adopt a reimbursement method, in which contributors would pay the full amount of their contribution assessments and then seek refunds from USAC for any exempted numbers, as recommended by AT&T and Verizon. AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 4. We find that adopting such a reimbursement requirements would create a significant administrative burden on contributors that would outweigh any potential benefits. Letter from Matthew A. Brill, Counsel for USA Mobility, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 2 (filed Oct. 24, 2008).

[350] We do not prejudge whether additional exceptions should apply if the Commission were to assess contributions based on numbers for business services. We note that certain businesses, such as non-profit health care providers, libraries, and colleges and universities, support such exemptions. We do not address those exemptions at this time.

mechanism.[351] As discussed above, all users of the network, even those who make few or no calls, receive a benefit by being able to receive calls, and therefore it is appropriate for these consumers to contribute to universal service.[352] Also as discussed above, to the extent low-volume consumers may see an increase in the amount of their universal service contribution pass-through fee,[353] any such increase should be slight.[354]

144. We also decline to exempt telematics providers,[355] one-way service providers,[356] and two-way paging services[357] from contributing based on numbers. We dis-

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[351] *See, e.g.*, CU et al. *Contribution First FNPRM* Comments at 12; NASUCA *Contribution First FNPRM* Comments at 14; Keep USF Fair Mar. 27, 2006 *Ex Parte* Letter, Attach. at 1.

[352] *See supra* para. 113; *see also* Sprint *Contribution First FNPRM* Comments at 7.

[353] *But see* IDT Aug. 2, 2007 *Ex Parte* Letter at 6-7 (arguing that low-volume consumers who make no long distance calls pay about $1.40 in universal service contribution assessments).

[354] *See supra* para. 112.

[355] Telematics is a service that is provided through a transceiver, which is usually built into a vehicle but can also be a handheld device, that provides public safety information to public safety answering points (PSAPs) using global positioning satellite data to provide location information regarding accidents, airbag deployments, and other emergencies in real time. *See, e.g.*, Letter from David L Sieradzki, Counsel for OnStar, to Marlene H. Dortch, FCC, CC Docket No. 96-45, Attach. at 1 (filed Mar. 2, 2006); *Revision of the Commission's Rules To Ensure Compatibility with Enhanced 911 Emergency Systems*, CC Docket No. 94-102, Order, 18 FCC Rcd 21531, 21531-33, paras. 2, 8 (2003).

[356] One-way services include, but are not limited to, one-way paging, electronic facsimile (e-fax), and voicemail services (other than stand-alone voicemail services, as discussed above).

[357] *See, e.g.*, Letter from Matthew Brill, Counsel for USA Mobility, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (filed Oct. 24, 2008) (opposing the assess-

agree with commenters arguing for special treatment for these services.[358] Granting exceptions for these services would provide them with an advantage over other services that are required to contribute based on residential telephone numbers. These services are receiving the benefit of accessing the public network and therefore assessing universal service contributions on these entities is appropriate.[359] These service providers have not shown

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ment of a numbers-based fee on paging carriers and their customers); Letter from Kenneth Hardman, representing the American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at Attach. (filed Oct. 22, 2008).

[358] *See* Letter from Ari Q. Fitzgerald, Counsel, Mercedes-Benz USA, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Apr. 12, 2006) (Mercedes-Benz Apr. 12, 2006 *Ex Parte* Letter); *see also* Letter from John E. Logan, ATX Group, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 2 (filed Mar. 16, 2006) (ATX Mar. 16, 2006 *Ex Parte* Letter); Letter from David M. Don, Counsel for j2 Global Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Nov. 18, 2005) (j2 Global Nov. 18, 2005 *Ex Parte* Letter); Letter from William B. Wilhelm, Jr., Counsel for Bonfire Holdings, to Tom Navin, Chief, Wireline Competition Bureau, CC Docket No. 96-45 (filed Feb. 13, 2006) (Bonfire Feb. 13, 2006 *Ex Parte* Letter); j2 Global *Contribution Second FNPRM* Comments at 2; Letter from Kenneth E. Hardman, Counsel for American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1 (filed Oct. 6, 2005) (AAPC Oct. 6, 2005 *Ex Parte* Letter); Letter from Frederick M. Joyce, Counsel for USA Mobility, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1-3 (filed Mar. 22, 2006) (USA Mobility Mar. 22, 2006 *Ex Parte* Letter).

[359] We similarly decline to adopt an exemption from the numbers-based contribution assessment method for services provided by alarm companies. *See* Letter from Donald J. Evans, Counsel for Corr Wireless Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 06-122, WT Docket No. 05 194, at 2 (filed Oct. 23, 2008). These services are receiving the

that grant of a contribution exception is warranted.[360] Accordingly, providers of these services will be assessed the full per-number charge. Some one-way service providers argue that their services are currently offered on a free, or nearly-free basis, and if these services are assessed on a per telephone number basis, providers will no longer be able to offer them.[361] We disagree that our

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benefit of having access to the PSTN and should therefore contribute to universal service.

[360] Telematics providers argue against imposition of a $1.00 per number per month contribution assessment on telematics numbers due to the service's critical role in advancing public safety, and because the $1.00 assessment would be prohibitively expensive. *See, e.g.*, Letter from Gary Wallace, Vice President Corporate Relations, ATX Group, Inc., to Kevin Martin, Chairman, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 1-2 (filed Oct. 28, 2008); OnStar Oct. 28, 2008 *Ex Parte* Letter at 3-4; Letter from Matthew Brill, Counsel for Toyota Motor Sales USA, Inc., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1-2 (filed Oct. 24, 2008). We find, however, that treating these services differently than other residential services would not be equitable, given their use of the PSTN and the ability of telematics providers to recover the assessment from their end users. Given the public safety benefit to consumers, we find unpersuasive the telematics' providers assertions that consumers will discontinue use of the service based on an assessment of only $1.00 per number. Furthermore, we disagree with commenters who argue that telematics service should be treated as a business service, and conclude that telematics service is a residential service that should be assessed under the $1.00 per number per month residential contribution methodology. *See* OnStar Oct. 28, 2008 *Ex Parte* Letter at 2; Letter from Tamara Preiss, Legal and External Affairs, Verizon Wireless, to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1 (filed Oct. 29, 2008).

[361] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 7 (arguing that a connections-based universal service methodology would force many heavily used one-way communications services out of existence).

change in contribution policy necessitates this result. Although these services may be marketed as "free" to the end user, these services are not truly free. Commercial providers of free or nearly-free services generate revenue in other ways, such as advertising or through more sophisticated paid service offerings or product offerings, and, therefore, whether they continue to offer free services would be a business decision based upon the circumstances of the particular business.[362] Indeed, we find that assessing a per-number contribution obligation on these services is consistent with our determination that services that benefit from a ubiquitous public network are fairly charged with supporting the network.

145. We also decline to adopt an exception from the residential numbers-based contribution mechanism for additional handsets provided through a wireless family plan. We do not agree with commenters who argue that telephone numbers assigned to the additional handsets in family wireless plans should be assessed at a reduced rate, either permanently or for a transitional period.[363] These commenters assert that assessing contributions at the full per-number rate would cause family plan customers to experience "rate shock."[364] Although family plan customers may see an increase in universal service con-

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[362] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 8 (describing a "free" service supported by advertising revenue).

[363] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter at 4; CTIA *2006 Contribution FNPRM* Comments at 5-6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2.

[364] *E.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 4; CTIA *2006 Contribution FNPRM* Comments at 5-6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2-3. *But see* AAPC Oct. 9, 2008 *Ex Parte* Letter at 2.

tribution pass-through charges on their monthly bills, we are not persuaded that the fear of "rate shock" justifies special treatment. We find that each number associated with a family plan obtains the full benefits of accessing the public network, and thus it is fair to assess each number with a separate contribution obligation. We also note that wireless service is one of the fastest-growing sectors of the industry and the record does not include persuasive data showing that a move to a numbers-based contribution methodology would have a significant, detrimental impact on wireless subscribership.[365] We agree with Qwest that an exception for additional family plan handsets would not be competitively neutral and would advantage approximately 70 million wireless family plan consumers over other residential service consumers.[366] Multiple wireline lines in a household are not given a discounted contribution assessment rate. We therefore decline to adopt a reduced assessment for wireless family plan numbers.

146. Some parties seek an exception to the contribution methodology we adopt today to exclude Internet-based telecommunications relay services (TRS), includ-

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[365] There are, as of December 2007, 249,235,715 mobile wireless subscribers, a more than 9% increase from the previous year. *See* FCC, LOCAL TELEPHONE COMPETITION: STATUS AS OF DECEMBER 31, 2007, tbl. 14 at 18 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-285509A1.pdf. Moreover, where a wireless provider is eligible to receive universal service support, it receives the same level of support for each handset. *See* WTA/OPASTCO/ITTA Oct. 10, 2008 *Ex Parte* Letter at 2.

[366] Qwest Sept. 24, 2008 *Ex Parte* Letter, Attach. at 7; Qwest May 4, 2006 *Ex Parte* Letter, Attach. at 9; *see also* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1.

ing video relay services (VRS) and IP Relay services.[367] We decline to adopt an exception for such providers at this time. The Commission has an open proceeding on a number of issues related to these providers, including whether certain costs to these providers related to the acquisition of ten-digit numbers by their customers should be reimbursed by the TRS fund.[368] We defer to that proceeding consideration of whether to adopt an exception to the contribution methodology we adopt today for numbers assigned to Internet-based TRS users.[369]

6. Reporting Requirements and Recordkeeping

147. Under the existing revenue-based contribution methodology, contributors report their historical gross-

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[367] *See* Letter from Deb MacLean, Communication Access Center for the Deaf and Hard of Hearing, et al. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 1-2 (filed Sept. 29, 2008) (CSDVRS Sept. 29, 2008 *Ex Parte* Letter).

[368] *See Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, CG Docket No. 03-123, WC Docket No. 05-196, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 11591, 11646, para. 149 (2008) ("We . . . seek comment on whether, and to what extent, the costs of acquiring numbers, including porting fees, should be passed on to the Internet-based TRS users, and not paid for by the [TRS] Fund. . . . We also seek comment on whether there are other specific costs that result from the requirements adopted in the *Order* that, mirroring voice telephone consumers, should be passed on to consumers, including, for example, E911 charges.").

[369] To the extent that Internet-based TRS users utilize a proxy number or identifier other than an assigned ten-digit number during/pending the transition to ten-digit numbering for Internet-based TRS services, we make clear that those numbers or identifiers are NOT subject to universal service contribution at this time. This treatment is necessary to ensure the smooth transition to ten-digit numbering for these services, and to prevent duplicative charges for end users of these services.

billed, projected gross-billed, and projected collected end-user interstate and international revenues quarterly on the FCC Form 499-Q and their gross-billed and actual collected end-user interstate and international revenues annually on the FCC Form 499-A.[370] Contributors are billed for their universal service contribution obligations on a monthly basis based on their quarterly projected collected revenue.[371] Actual revenues reported on the FCC Form 499-A are used to perform true-ups to the quarterly projected revenue data.[372]

148. We will develop a new and unified reporting system to accommodate our new universal service contribution methodology.[373] Contributors will report their As-

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[370] *See, e.g.*, *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969, para. 29. Filers are required to file revisions to FCC Form 499-Q within 45 calendar days of the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499 Q, at 10 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-Q/499q.pdf. Filers are required to file revisions to FCC Form 499-A by March 31 of the year after the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499-A, at 11-12 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-A/499a-2008.pdf.

[371] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 35.

[372] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 36.

[373] We decline to adopt the suggestion by AT&T and Verizon to transition the Telecommunications Relay Services Fund, local number portability cost recovery, and numbering administration to a numbers/connections-based assessment methodology. *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 6. Although these programs rely on the revenue information reported in the current FCC Form 499-A, they do not rely on many of the revenue distinctions, such as interstate and intrastate, that necessitate the change from a revenue-based assessment for the universal service fund.

sessable Number counts on a monthly basis. Contributors must report as an Assessable Number any such number that is in use by an end user during any point in the relevant month. The Commission will develop an additional version of the FCC Form 499 for use in reporting Assessable Numbers. Under the interim business revenue-based reporting component, contributors will report their revenue information on the modified FCC Forms 499-A and 499-Q.

149. Under the new numbers-based system we adopt today, contributors will report historical Assessable Numbers monthly. Contributors will then be invoiced and required to contribute the following month. By reporting actual, historical numbers, the numbers-based component of our contribution methodology remains simple and straightforward. As explained above, a key reason to move to a primarily numbers-based approach is its simplicity. Indeed, several commenters propose monthly reporting of historical number counts.[374] We find that reporting Assessable Numbers on a projected collected basis would unnecessarily complicate the numbers-reporting system. Although we are mindful of the issues inherent in historical reporting,[375] we find that a one month lag between the reported Assessable Numbers and the contribution based on those numbers is minimal and will not unfairly disadvantage any provider, even those with a declining base.

150. We allow contributors to self-certify which telephone numbers are, consistent with this order, consid-

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[374] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 2-3; CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 5; USF by the Numbers Oct. 3, 2008 *Ex Parte* Letter.

[375] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969-70, paras. 29-32.

ered "residential." Contributors will be subject to audit, however, and their method for distinguishing residential from other numbers must be reasonable and supportable. For example, in the Commission's *Broadband Data Gathering Order* released earlier this year, the Commission directed mobile wireless service providers "to report as residential subscriptions those subscriptions that are not billed to a corporate account, to a non-corporate business customer account, or to a government or institutional account."[376] We added that "[f]or purposes of Form 477, subscriptions billed to a federal government department or agency, for example, will not be 'residential' subscriptions, while subscriptions to a service plan offered to all federal government employees will be considered to be residential subscriptions."[377] For purposes of identifying numbers associated with business services (which are not Assessable Numbers), contributors may rely on the fact that the line associated with that number is assessed a *multi-line* end user common line charge (i.e., SLC); provided, however, that the SLC must be a mandatory charge, rather than a discretionary charge.[378]

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[376] *Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, 23 FCC Rcd 9691, 9704, para. 24 (2008) (*Broadband Data Gathering Order*), Order on Reconsideration, 23 FCC Rcd 9800 (2008).

[377] *Broadband Data Gathering Order* at para. 24 n.91.

[378] In other words, the SLC type and rate must be established pursuant to the Commission's rules. 47 C.F.R. §§ 69.104(c)(1), 69.152(k)(1). To the extent that the contributor is not required to charge a SLC (e.g., is not rate-regulated by the Commission), a voluntary business choice to include a "subscriber line charge" on a customer's bill may not be dispositive of the type of service, residential or business, being provided.

For determining residential numbers (which are Assessable Numbers), however, a contributor may not rely on the assessment of a residential SLC, because SLC rates are the same for residential and single-line business end users. Therefore, the fact that a contributor charges the single-line business/residential SLC may not accurately indicate whether the service provided is a business or residential service.[379]

151. Each contributor must maintain the necessary internal records to justify, in response to an audit or otherwise, its reported Assessable Number counts and the data reported on the Commission's contribution forms.[380] Contributors are responsible for accurately including all Assessable Numbers associated with residential services in their Assessable Number counts and revenues from all business services in the interim business services revenue component of the methodology. Failure to file the required form by the applicable deadline, or failure to file accurate information on the form, could subject a contributor to enforcement action.[381] In addition, as with the current FCC Forms 499-A and 499-Q, we will require that an officer of the filer certify to the truthfulness and accuracy of the forms submitted to the administrator.

152. To ensure that filers report correct information, we continue to require all reporting entities to maintain records and documentation to justify the information reported in these forms, and to provide such records and

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[379] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1).

[380] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 27.

[381] Pursuant to section 1.80 of the Commission's rules, failure to file required forms or information carries a base forfeiture amount of $3,000 per instance and is subject to adjustment criteria. *See* 47 C.F.R. § 1.80.

documentation to the Commission and to USAC upon request.[382] All universal service fund contributors are required to retain their records for five years.[383] Specifically, contributors to the universal service fund must retain all documents and records that they may require to demonstrate to auditors that their contributions were made in compliance with the program rules, assuming that the audits are conducted within five years of such contribution. Contributors further must make available all documents and records that pertain to them, including those of contractors and consultants working on their behalf, to the Office of Inspector General, to USAC, and to their respective auditors. These documents and records should include without limitation the following: financial statements and supporting documentation; accounting records; historical customer records; general ledgers; and any other relevant documentation.[384]

153. Further, we make clear that for purposes of the interim business revenue component, we retain all existing reporting requirements associated with the filing of the FCC Forms 499-A and 499-Q for business service revenue. Finally, we direct the Bureau, and delegate to the Bureau the authority, to develop or modify the necessary forms to ensure proper contribution reporting occurs, consistent with this order.

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[382] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; *see also* 47 C.F.R. §§ 54.706(e), 54.711(a).

[383] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; 47 C.F.R. § 54.706(e).

[384] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, paras. 27-28. We note that contributors who also report NRUF data to the NANPA are currently required to maintain internal records of their numbering resources for audit purposes. *NRO I Order*, 15 FCC Rcd at 7601, para. 62.

7. Transition to New Methodology

154. The new reporting procedures discussed above will require reporting entities to adjust their record-keeping and reporting systems in order to provide reports to USAC regarding the number of Assessable Numbers and to adjust their revenue information to include only business service revenue. Accordingly, we implement a 12-month transition period for the new contribution mechanisms.[385] This transition period will give contributors ample time to adjust their record-keeping and reporting systems so that they may comply with modified reporting procedures. As explained below, a 12-month transition period will also allow reporting entities to submit several reports for informational purposes before being assessed on the basis of projected Assessable Numbers for residential services.[386] We find, therefore, that a 12-month transition period balances administrative burdens on contributors with the need to implement the new contribution methodologies in a balanced and equitable manner.

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[385] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (proposing a 12-month transition to the new mechanism taking effect).

[386] *See* CTIA *2006 Contribution FNPRM* Comments at 7; *see also* Verizon and AT&T Sept. 11, 2008 *Ex Parte* Letter, Attach. at 2 (advocating a 12-month implementation period followed by a 6-month transition period). Some parties advocated for a transition period as short as possible. *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, Attach. at 2 (filed Sept. 19 2008) (CenturyTel Sept. 19, 2008 *Ex Parte* Letter); Sprint Nextel June 14, 2006 *Ex Parte* Letter. Others advocated for a longer transition period. *See, e.g.*, Qwest Mar. 21, 2006 *Ex Parte* Letter, Attach. at 3 (advocating 18 months); XO Communications Oct. 3, 2008 *Ex Parte* Letter, Attach. at 11 (advocating at least 18 months).

155. During 2009, filers will continue reporting their interstate telecommunications revenue on a quarterly basis and USAC will continue assessing contributions to the federal universal service mechanisms based on those quarterly reports. This one-year period and, in particular, the first six months of that period, should be used by contributors to adjust their internal and reporting systems to prepare for the reporting of Assessable Numbers and business revenues.

156. Beginning in July 2009, contributors will continue to report and contribute based on their quarterly reported interstate and international revenues for the last two quarters of the year, but they will also begin filing with USAC monthly reports of their Assessable Numbers and quarterly reports of their business revenues. USAC will thus collect data under the old revenue-based methodology, while collecting and reviewing data under the new Assessable Number and business revenues methodologies for the last six months of 2009. We find that this six-month period of double-reporting is necessary to help reporting entities, Commission staff, and USAC identify implementation issues that may arise under this new methodology prior to it taking effect.[387] Although only the December 2009 Assessable Numbers and the fourth quarter 2009 business revenue data will be used to compute contributors' January 2010 and first quarter 2010 assessments, we find it is reasonable to require contributors to begin filing under the new methodologies prior to these periods to ensure that there is adequate time for all affected parties to address any implementation issues that may arise. Moreover, we conclude

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[387] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (recommending a six-month transition period for filers and USAC to test and calibrate the new system prior to its taking effect).

that the short overlap of reporting under both the old and new methodologies will not be unduly burdensome for contributors given the limited duration of the dual reporting.

V. REFORM OF INTERCARRIER COMPENSATION

157. Since Congress first passed the Communications Act in 1934, the Commission has sought "to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[388] To promote universal service, regulators have long relied on a complex array of intercarrier compensation mechanisms, which generally have included implicit subsidies. Through the years, the introduction of competition into first long-distance and then local markets, as well as the development and deployment of new technologies, have eroded the fundamental economic underpinnings of the current intercarrier compensation regimes. The reforms we adopt in this order are designed to unify and simplify the myriad intercarrier compensation systems in existence today. This unification and simplification will encourage the efficient use of, and investment in, advanced telecommunications and broadband networks, spur intermodal competition throughout the United States, and minimize the need for future regulatory intervention.

158. Today, we adopt a new approach to intercarrier compensation and establish the blueprint for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we rec-

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[388] 47 U.S.C. § 151.

ognize, as the Commission has in the past, that we need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan, with separate stages, designed to reduce rates over a sufficient period to minimize market disruptions and to cushion the impact of our reform on both customers and carriers. At the end of the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

A. A Brief History of Intercarrier Compensation

159. This section provides an overview of the development of intercarrier compensation regulation in the United States. Although not comprehensive, it highlights several important goals that have emerged in Commission precedent, which are relevant to intercarrier compensation reform.

- *Promoting universal service.* The Commission has sought to promote universal service, and, in furtherance of that objective, an intricate web of implicit subsidies evolved that were intended to keep the price of residential local telephone service affordable, even if that price was below cost. With the introduction of competition for long-distance telephone service, regulators sought to maintain implicit subsidies of local service when they created regulated intercarrier compensation charges, known as "access charges," that long-distance

service providers paid local telephone companies to originate and terminate long-distance calls.

- *Encouraging efficient use of the network.* The Commission has long recognized that requiring end-users to bear a greater proportion of the cost of the local network encourages them to make rational choices in their use of telephone service. The Commission nevertheless has declined to shift a significant percentage of the cost of the network to those end users in light of universal service concerns.
- *Realigning cost recovery in response to competition.* For much of the twentieth century, telephone service was viewed as a natural monopoly. The emergence of competition for long-distance services in the 1970s and for local services, particularly after the 1996 Act, has placed pressure on above-cost intercarrier compensation charges. Although the Commission, in response to competitive entry, sought to develop intercarrier compensation rules that align more closely with the economic principle that costs should be recovered in the way they are incurred, marketplace developments confirm that those efforts were incomplete. As new competitors entered, a series of regulatory arbitrage strategies developed, some of which the Commission has attempted to address on a case-by-case basis.
- *Technological advancements.* As carriers shift from circuit-switched telephone-only networks to packet-switched broadband networks supporting numerous services and applications, it

is important that intercarrier compensation rules create the proper incentives for carriers to invest in new broadband technology and that consumers have the opportunity to take full advantage of the new capabilities of this broadband world.

1. Intercarrier Compensation Regulation Before the Telecommunications Act of 1996

160. When AT&T began offering telephone service in 1877,[389] it held all the essential patents and effectively operated as a legal monopoly. When the original patents expired in 1894, however, thousands of independent telephone companies began offering competing local telephone service.[390] This new competition led to lower rates,[391] and reduced AT&T's average return on investments by over 80 percent.[392] AT&T responded by refus-

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[389] The company that became AT&T was originally called the Bell Telephone Company. *See* AT&T, A Brief History: Origins, http://www.corp.att.com/history/history1.html (last visited Sept. 11, 2008) (AT&T Brief History). For simplicity, we use the term "AT&T" to include all predecessor companies.

[390] Between 1894 and 1904, "over six thousand independent telephone companies went into business in the United States, and the number of telephones boomed from 285,000 to 3,317,000." *See* AT&T Brief History. By 1900, independent telephone companies controlled "38 percent of the phones installed in the United States." GERALD W. BROCK, THE TELECOMMUNICATIONS INDUSTRY, THE DYNAMICS OF MARKET STRUCTURE 148 (1981) (THE TELECOMMUNICATIONS INDUSTRY). And, by 1902, 451 out of 1002 cities with telephone service had two or more competing providers. *See* MICHAEL K. KELLOGG ET AL. FEDERAL TELECOMMUNICATIONS LAW 11 (1992) (FEDERAL TELECOMMUNICATIONS LAW).

[391] THE TELECOMMUNICATIONS INDUSTRY at 116.

[392] FEDERAL TELECOMMUNICATIONS LAW at 11; *see also* Adam D. Thierer, *Unnatural Monopoly: Critical Moments In The Development Of The Bell System Monopoly*, 14 CATO J. 2 (1994), *available*

ing to interconnect with any independent telephone company to exchange long-distance or local traffic.[393] Without interconnection, independent telephone companies could not offer a viable service unless such entities duplicated the AT&T system, which was not economically feasible. As a result, independent telephone companies began to go out of business or were acquired by AT&T.[394]

161. AT&T's predatory strategy led the Department of Justice to file an antitrust suit against AT&T in 1913. The government alleged that AT&T's interconnection and acquisition policies violated Section 2 of the Sherman Act.[395] The case was eventually dropped after AT&T committed to abide by certain principles in what became

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at http://www.cato.org/pubs/journal/cjv14n2-6.html (*Unnatural Monopoly*). Although independent companies competed with AT&T for local service, AT&T had the only long-distance network operating at the time and possessed important long-distance technology patents. *See* THE TELECOMMUNICATIONS INDUSTRY at 148. According to Brock, there is some evidence that the independent companies had planned on starting a separate long-distance network until AT&T refused interconnection. GERALD W. BROCK, THE SECOND INFORMATION REVOLUTION 30-32 (2003) (SECOND INFORMATION REVOLUTION).

[393] FEDERAL TELECOMMUNICATIONS LAW at 11-12; THE TELECOMMUNICATIONS INDUSTRY at 148; David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894-1912*, 102 J. POL. ECON. 103, 103-26 (1994).

[394] FEDERAL TELECOMMUNICATIONS LAW at 11. In 1912 alone, AT&T purchased 136,000 telephone companies and sold 43,000. *See* THE TELECOMMUNICATIONS INDUSTRY at 156.

[395] Original Petition, *United States v. AT&T*, No. 6082 (D. Or. 1913); *United States v. AT&T*, No. 6082, 1 DECREES AND JUDGMENT IN CIVIL ACTION CASES 483 (D. Or. 1914); *see also* PETER TEMIN, THE FALL OF THE BELL SYSTEM: A STUDY IN PRICES AND POLITICS 9-10 (1987); ROBERT W. GARNET, THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM'S HORIZONTAL STRUCTURE, 1876-1909 152-53 (1985).

known as the Kingsbury Commitment of 1913. Under the Kingsbury Commitment, AT&T agreed to: (i) allow independent telephone companies to interconnect with AT&T's long-distance network; and (ii) not acquire any additional independent telephone companies absent regulatory approval.[396] In exchange, the government sanctioned AT&T's monopoly control over markets where it already offered service.

162. In essence, the Kingsbury Commitment and subsequent regulation assumed that both the local and long-distance telephone businesses were natural monopolies.[397] Policymakers embraced the view that, because of economies of scale, a natural monopoly could provide service more efficiently than would occur in a competitive

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[396] The Kingsbury Commitment was a "unilateral letter rather than an actual consent decree." *See* THE TELECOMMUNICATIONS INDUSTRY at 155. The Kingsbury Commitment was republished in AT&T's 1913 Annual Report at 24-26, *available at* http://www.porticus.org/bell/pdf/1913ATTar_Complete.pdf. AT&T also agreed to sell off its Western Union stock, a large independent telephone company that AT&T had recently acquired. *See id.* at 24. *See* FEDERAL TELECOMMUNICATIONS LAW at 11-12; *see also Unnatural Monopoly*.

[397] *See, e.g.*, *Unnatural Monopoly* (noting that a Senate Commerce Committee hearing in 1921 stating that "telephoning is a natural monopoly" and a House of Representative committee report stated that "[t]here is nothing to be gained by local competition in the telephone business.") (quoting G. H. Loeb, *The Communications Act Policy Toward Competition: A Failure to Communicate*, 1 DUKE LAW J. 14 (1978)); *see also id.* (explaining that many state regulatory agencies began refusing requests by telephone companies to construct new lines in areas already served by another carrier and continued to encourage monopoly swapping and consolidation in the name of "efficient service") (citing Warren G. Lavey, *The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915*, 39 FED. COMM. L.J. 171, 184-85 (1987)); FEDERAL TELECOMMUNICATIONS LAW at 17.

market.[398] Rates for these natural monopolies were subject to rate-of-return regulation.[399] In setting regulated rates, a primary policy objective of regulators was to promote universal service to all consumers through affordable local telephone rates for residential customers. To accomplish this objective, however, regulators created a patchwork of what has become known as implicit subsidies. Thus, for example, regulators permitted higher rates to business customers so that residential rates could be lower, and they frequently required similar rates to urban and rural customers, even though the cost of serving rural customers was higher.[400] Similarly, AT&T was permitted to charge artificially high long-distance toll rates, and its interstate toll revenues were

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[398] A natural monopoly arises "when a single firm can efficiently serve the entire market because average costs are lower with one firm than with two firms." R. PRESTON MCAFEE, INTRODUCTION TO ECONOMIC ANALYSIS 6-241 (2006), *available at* http://www.mcafee.cc/Introecon/IEA.pdf; *see also* DANIEL F. SPULBER, REGULATION AND MARKETS 3-4 (1989) ("Natural monopoly generally refers to a property of productive technology, often in conjunction with market demand, such that a single firm is able to serve the market at less cost than two or more firms. Natural monopoly is due to economies of scale or economies of multiple-output production.").

[399] For discussions of rate of return regulation, see, *e.g.*, JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES 197-376 (1988); CHARLES F. PHILLIPS, JR., THE ECONOMICS OF REGULATION: THEORY AND PRACTICE IN THE TRANSPORTATION AND PUBLIC UTILITY INDUSTRIES 260-302 (1969) (PHILLIPS, THE ECONOMICS OF REGULATION); 1 ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 20-58 (1970) (THE ECONOMICS OF REGULATION).

[400] *See, e.g.*, JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS: AMERICAN TELECOMMUNICATIONS POLICY IN THE INTERNET AGE 10-15 (2007) (DIGITAL CROSSROADS).

placed into an interstate "settlements" pool.[401] AT&T then shared a portion of these interstate revenues with independent telephone companies and AT&T's affiliated Bell Operating Companies (BOCs).[402] These high long-distance rates enabled regulators to set lower local rates for the BOCs and independent local telephone companies.

163. The use of microwave technology by Microwave Communications, Inc. (MCI), to offer a competitive alternative to AT&T's switched long-distance service beginning in the 1970s cast into doubt the assumption that long-distance telecommunications was a natural monopoly.[403] MCI focused initially on private line service, where AT&T's rates were above cost. MCI's service offerings grew after a series of Commission and court decisions rejected AT&T's objections to MCI's entry.[404] Despite

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[401] *See Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Information, Jurisdictional Separations and Rate Structures*, Docket No. 20003, First Report, 61 FCC 2d 766, 796-97, paras. 81-82 (1976).

[402] Under the settlements process, the local exchange companies were allowed to recover the portion of their costs allocated to the interstate jurisdiction from the interstate toll revenues. The process for affiliated companies was a process of intracorporate accounting known as "division of revenues," while the process for unaffiliated companies represented real payments from AT&T to the independent companies. *See* THE SECOND INFORMATION REVOLUTION at 188. According to Brock, the revenue sharing settlements process was a major source of support for small rural companies, which often could recover a large share of their costs from the interstate toll revenue pool (in some cases as much as 85% of their non-traffic sensitive costs). *See id.*

[403] *See* DIGITAL CROSSROADS at 60-64.

[404] AT&T argued that MCI would cherry pick the most profitable customers (those paying above-cost rates) and force AT&T to increase local rates thereby undermining the goal of universal service

these victories, MCI was not entitled to equal access to local exchange service,[416] and MCI and other IXCs were dependent on the BOCs and independent local telephone companies to complete long-distance calls to the end users.[417]

164. For a number of reasons, including AT&T's resistance to the introduction of competition in the long-distance market, the Department of Justice in 1974 filed an antitrust suit alleging that AT&T had engaged in unlawful monopolization in the local, long-distance, and equipment manufacturing markets.[417] After eight years

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AT&T opposed the entry of MCI before the Commission and the courts. *See* FEDERAL TELECOMMUNICATIONS LAW at 602 14; *Bell System Tariff Offerings of Local Distribution Facilities for Use by Other Common Carriers*, Docket No. 19896, Decision, 46 FCC 2d 413 (1974), *aff'd Bell Tel. Co. of Pa. v. FCC*, 503 F.2d 1250 (3d Cir. 1974); *see also* DIGITAL CROSSROADS at 60-64 (noting that AT&T fought "tooth and nail" to deprive MCI of effective access and even unplugged certain MCI lines from AT&T's network).

[416] Equal access requires that all long-distance carriers be accessible by dialing a 1 and not a string of long-distance codes before dialing the called party's telephone number. *See, e.g.*, HARRY NEWTON, NEWTON'S TELECOM DICTIONARY 326 (16th ed. 2000).

[417] During much of the 1970s, AT&T and MCI debated before the Commission and courts about the charges that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. In December 1978, under the Commission's supervision, AT&T, MCI, and other IXCs entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), which set the rates that AT&T's affiliated BOCs would charge IXCs for originating and terminating access to local exchange networks. *See Exchange Network Facilities for Interstate Access (ENFIA)*, CC Docket No. 78-371, Memorandum Opinion and Order, 71 FCC 2d 440 (1979) (subsequent history omitted).

[417] *See United States v. AT&T*, 524 F. Supp. 1336, 1346 (D.D.C. 1981).

of litigation, AT&T and the Department of Justice entered into a consent decree, which federal District Court Judge Greene approved in 1982.[408] Under the Modification of Final Judgment (MFJ), AT&T agreed to divest its affiliated BOCs from AT&T long distance, and the BOCs were required to provide equal access and dialing parity.[409] In addition, the MFJ barred the BOCs from entering the long-distance, information services, equipment manufacturing, or other competitive markets to prevent predatory cross subsidization by their regulated monopoly local telephone service.[410] Although the MFJ applied only to the BOCs, the Commission subsequently extended interconnection and nondiscriminatory equal access obligations to all incumbent LECs.[411] As a result of the MFJ, MCI, and other competitors were able to com

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[408] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The 1982 consent decree, as entered by the court, was called the Modification of Final Judgment because it modified a 1956 Final Judgment against AT&T stemming from a 1949 antitrust lawsuit. *See* THE TELECOMMUNICATIONS INDUSTRY at 116-20.

[409] The Act defines "dialing parity" to mean that a "person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier)." 47 U.S.C. § 153(15).

[410] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982).

[411] *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983) (*1983 Access Charge Order*), *modified on recon.*, 97 FCC 2d 682 (1983), *modified on further recon.*, 97 FCC 2d 834 (1983), *aff'd in part and remanded in part, Nat'l Ass'n of Regulatory Util. Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984).

pete directly with AT&T to provide long-distance or interstate service, and all IXCs paid interstate access charges to the BOCs and other incumbent LECs to originate and terminate service to end users.

165. While the AT&T antitrust suit was pending, the Commission began to take the first steps toward reforming intercarrier compensation. In 1978, the Commission commenced a review of intercarrier compensation for originating and terminating access.[412] In 1983, following the MFJ, the Commission eliminated the "existing potpourri of [compensation] mechanisms,"[413] and replaced it "with a single uniform mechanism . . . through which local carriers [could] recover the cost of providing access services needed to complete interstate and foreign telecommunications."[414] The access charge rules adopted by the Commission provided for the recovery of incumbent LECs' costs assigned to the interstate jurisdiction and detailed "the precise manner in which [incumbent LECs] may assess charges on IXCs and end users."[415] In designing the interstate access charge rules, the Commis-

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[412] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Notice of Inquiry and Proposed Rulemaking, 73 FCC 2d 222 (1979); Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980); Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980); and Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, 90 FCC 2d 135 (1982).

[413] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 683, para. 2 (1983) (*First Reconsideration of 1983 Access Charge Order*).

[414] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682.

[415] *See Access Charge Reform Order*, 12 FCC Rcd at 15991-92, para. 22.

sion sought to balance a number of competing objectives.[416] For one, the Commission recognized that "[a]rtificial pricing structures, while perhaps appropriate for use in achieving social objectives under the right conditions, cannot withstand the pressures of a competitive marketplace."[417] Consequently, the Commission sought to follow more closely the principle that costs should be recovered in the way they are incurred, consistent with principles of cost-causation.[418] Under this rate structure principle, the cost of facilities that do not vary based on the amount of traffic carried over those facilities (i.e., non-traffic-sensitive costs) should be recovered through fixed, flat-rated charges, while only costs that vary with usage of facilities (i.e., traffic-sensitive costs) should be recovered through corresponding per-minute rates.[419]

166. Despite these rate structure principles, the Commission concluded that a sudden introduction of large flat-rated charges on end-users could have "adverse effects" on subscribership. It therefore adopted a "plan [that] provides for the gradual introduction of these end-

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[416] *See, e.g., First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 683, para. 3 (identifying the four primary objectives of: (1) elimination of unreasonable discrimination and undue preferences among rates for interstate services; (2) efficient use of the local network; (3) prevention of uneconomic bypass; and (4) preservation of universal service).

[417] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 686, para. 7.

[418] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 688-89, para. 10; *see also Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24 ("The Commission has recognized in prior rulemaking proceedings that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation.").

[419] *Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 23.

user charges."[420] Thus, the Commission limited the amount of the interstate loop costs assessed to residential and business customers as a flat-rated monthly charge, and it recovered the remaining interstate loop costs through a per-minute charge imposed on IXCs.[421] Moreover, the Commission continued to apply traditional rate-of-return regulation based on carriers' embedded, fully distributed costs, including common costs and overhead.[422]

167. In 1991, the Commission took another step toward intercarrier compensation reform by replacing rate-of-return regulation with an incentive-based system

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[420] *1983 Access Charge Order*, 93 FCC 2d at 253, para. 35; *see also id.* at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act."). As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[421] This per-minute charge was called the carrier common line charge. *See Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24. Additional charges were imposed on IXCs to recover the interstate portion of the costs of other parts of a local exchange carrier's network, such as local switches and transport. *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 735–40, paras. 129-34, 137-43.

[422] *See* 47 C.F.R. §§ 69.301-.502; *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6787, para. 1 (1990) (*LEC Price Cap Order*). The rate-of-return regulations are set forth in Part 69 of our rules. *See generally* 47 C.F.R. §§ 69.1-701.

of regulation for the BOCs and GTE.[423] This new regulatory regime, known as price cap regulation, was designed to replicate some of the efficiency incentives found in competitive markets. In particular, price caps were designed to encourage companies to: (1) improve their efficiency by creating incentives to reduce costs; (2) invest efficiently in new plant and facilities; and (3) develop and deploy innovative service offerings.[424] Although many

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[423] Price cap regulation was mandatory for the BOCs and GTE and optional for other incumbent local exchange carriers. *See LEC Price Cap Order*, 5 FCC Rcd at 6818-20, paras. 257-79; *see also Access Charge Reform; Price Cap Performance Review for Local Exchanges Carriers; Interexchange Carrier Purchases of Switch Access Services Offered by Competitive Local Exchange Carriers; Petition of U.S. West Comme'ns, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14224 n.1 (1999) (*Pricing Flexibility Order*).

[424] *LEC Price Cap Order*, 5 FCC Rcd at 6789-91, paras. 21-37; *Special Access Rates for Price Cap Carriers*, WC Docket No. 05-25, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, 1998-99, para. 11 (2005); *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, CC Docket Nos. 96-149, 98-141, 96-149, 01-337, Report and Order, Memorandum Opinion and Order, 19 FCC Rcd 5102, 5115, para. 22 (2004); *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd 14976, 14979, para. 4 (2003); *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10873, para. 9 (2002). *See also Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order, 23 FCC Rcd 5294 (2008); *Petition of Puerto Rico Telephone Company, Inc. for Election of Price Cap Regulation and Limited Waiver of Pricing and Universal Service Rules; Consolidated Communications Petition*

smaller and rural incumbent LECs remain subject to the Part 69 rate-of-return rules, most of the larger incumbent LECs are now subject to price cap regulation.[425]

168. The Commission's reforms during the 1980s and early 1990s yielded many public interest benefits. For example, economists have estimated that above-cost access charges reduced U.S. economic welfare by an estimated $10-17 billion annually during the late 1980s, but that the annual welfare loss declined substantially to between $2.5 billion and $7 billion following the Commission's access charge reforms in the 1980s and early 1990s.[426] Despite these reforms, however, per-minute access rates remained high.[427] These high switched access rates created an opportunity for competitive access providers (CAPs) to begin offering facilities-based competition. CAPs could offer carriers a competitive alternative to the BOCs, often with lower rates and higher quality.[428]

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for Conversion to Price Cap Regulation and for Limited Waiver Relief; Frontier Petition for Limited Waiver Relief upon Conversion of Global Valley Networks, Inc., to Price Cap Regulation, WC Docket Nos. 07-291, 07-292, 08-18, Order, 23 FCC Rcd 7353 (2008).

[425] *See generally* 47 C.F.R. §§ 61.1-.193, 69.1-.701.

[426] *See* Letter from Jerry Ellig, Senior Research Fellow, Mercatus Center, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 08-183, 07-135, 05-337, 99-68 at 2 (filed Sept. 22, 2008) (Mercatus Center Sept. 22, 2008 *Ex Parte* Letter) (citing ROBERT W. CRANDALL, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA 141 (1991) and ROBERT W. CRANDALL & LEONARD WAVERMAN, WHO PAYS FOR UNIVERSAL SERVICE? 120 (2000)).

[427] Among the reasons that switched access rates remained high were that they were based on fully distributed costs and included a large allocation of common and overhead network costs. *See supra* note 422.

[428] *See, e.g., Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Memorandum Opinion and

The entry of CAPs and the potential entry of cable companies into local residential telephone markets created pressure toward opening the local telephone markets to competition, which ultimately resulted in the passage of the 1996 Act.

2. Intercarrier Compensation Regulation Since the 1996 Act

169. Recognizing these fundamental market changes, Congress's goals in passing the 1996 Act were to: (1) open local exchange and exchange access markets to competition; (2) promote increased competition in telecommunications markets that were already open to competition; and (3) reform the existing universal service system to be consistent with competitive markets.[429] With respect to the last goal, Congress recognized that implicit subsidies, which were implemented when the industry was considered a natural monopoly, were neither consistent with, nor sustainable in, a competitive market, and that they should be replaced with explicit support where necessary.[430] It also recognized, however, that con-

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Order, 9 FCC Rcd 5154, 5158, para. 8 (1994) (recognizing that local competition should lead to more efficient operations, the deployment of "new technologies facilitating innovative service offerings, increase the choices available to access customers, and reduce the prices of services subject to competition").

[429] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15505, para. 3 (1996) (subsequent history omitted) (*Local Competition First Report and Order*).

[430] Specifically, Congress directed that universal service support "should be explicit and sufficient to achieve the purposes" of section 254. 47 U.S.C. § 254(e); *see also* S. REP. No. 104-230, at 131 (1996) (Conf. Rep) (stating that, "[t]o the extent possible, . . . any support mechanisms continued or created under new section 254 should be

version of the existing web of implicit subsidies to a system of explicit support would be a difficult task that could not be accomplished immediately.[431] Accordingly, when Congress established the statutory scheme to open local markets to competition,[432] it included a transitional mechanism in section 251(g) providing for the continued enforcement of certain pre-Act obligations.[433] Notably, section 251(g) provides for the continued enforcement of exchange access and interconnection obligations only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after the date of such enactment," suggesting that such obligations would be reevaluated based on the requirements imposed by the 1996 Act.[434]

170. Congress also recognized the need to impose new obligations on carriers to open local telephone markets to competition, and directed the Commission to adopt implementing rules. Specifically, section 251(b) imposed certain obligations on all LECs, while section 251(c) imposed additional obligations on incumbent LECs, including the obligation to provide access to net-

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explicit, rather than implicit as many support mechanisms are today").

[431] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[432] *See* 47 U.S.C. §§ 251-52; *Local Competition First Report and Order*, 11 FCC Rcd at 15505, para. 3.

[433] *See* 47 U.S.C. § 251(g); *WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002) (*WorldCom*) (subsequent history omitted) (holding that section 251(g) appears to provide for the continued enforcement "of certain pre-Act regulatory 'interconnection restrictions and obligations'"); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) (finding that section 251(g) preserves certain rate regimes already in place and "leaves the door open for the promulgation of new rates at some future date").

[434] 47 U.S.C. § 251(g).

work elements on an unbundled basis.[435] Of relevance here, section 251(b)(5) of the 1996 Act imposed on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[436]

171. In requiring LECs to enter into reciprocal compensation agreements with requesting carriers, Congress introduced another mechanism through which carriers compensate each other for the exchange of traffic besides the access charge regime preserved under section 251(g). Although Congress expressed a preference for negotiated interconnection agreements to implement the requirements of section 251, section 252 provided procedures for the resolution of interconnection disputes involving incumbent LECs, including standards governing arbitration of such disputes by state regulatory commissions.[437] For such state arbitrations, section 252(d) also established general pricing guidelines for incumbent LECs, including guidelines for setting the price of unbundled network elements (UNEs)[438] and reciprocal compensation rates.[439]

172. In the *Local Competition First Report and Order*, the Commission adopted pricing rules for states to use in setting the price of interconnection and UNEs

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[435] *See* 47 U.S.C. §§ 251(b)-(c). Certain rural carriers were exempt from section 251(c) until such time as a requesting carrier met the statutory test for removing the so-called "rural exemption." *See* 47 U.S.C. § 251(f)(1).

[436] 47 U.S.C. § 251(b)(5).

[437] 47 U.S.C. § 252.

[438] 47 U.S.C. § 252(d)(1).

[439] See 47 U.S.C. § 252(d)(2).

when arbitrating interconnection disputes.[440] In particular, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, which it called "Total Element Long-Run Incremental Cost" or "TELRIC."[441] The Commission found that TELRIC prices should include a reasonable allocation of forward-looking common costs, including overheads.[442] Although the Commission recognized that peak-load pricing was the most efficient way to recover the cost of traffic-sensitive facilities, it did not require states to adopt peak-load pricing because of the adminis-

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[440] *See Local Competition First Report and Order*, 11 FCC Rcd at 15812-929, paras. 618-862 (implementing the pricing principles contained in sections 251(c)(2) and (c)(3) and section 252(d)(1) of the 1996 Act); *see also* 47 U.S.C. §§ 251(c)(2)-(3), 252(d)(1). Among other things, the 1996 Act required incumbent LECs to make portions of their networks (the physical facilities and features, functions, and capabilities associated with those facilities) available to requesting competitive carriers on an unbundled basis. *See Local Competition First Report and Order*, 11 FCC Rcd at 15624, 15631, paras. 241, 258.

[441] *See Local Competition First Report and Order*, 11 FCC Rcd at 15844-56, paras. 672-703.

[442] *See Local Competition First Report and Order*, 11 FCC Rcd at 15851-54, paras. 694-98; 47 C.F.R. §§ 51.503, 51.505. The term "common costs" refers to "costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies." *Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676. In its rules, the Commission defines forward-looking common costs as "economic costs efficiently incurred in providing a group of elements or services . . . that cannot be attributed directly to individual elements or services." 47 C.F.R. § 51.505(c)(1). The term "overhead costs" refers to common costs incurred by the firm's operations as a whole, such as the salaries of executives. *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 694.

trative difficulties associated with such an approach.[443] In interpreting the statutory pricing rules for reciprocal compensation contained in section 252(d)(2)(A) of the 1996 Act,[444] the Commission found that costs for trans-

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[443] The Commission recognized that, "[b]ecause the cost of capacity is determined by the volume of traffic that the facilities are able to handle during peak load periods, we believe, as a matter of economic theory, that if usage-sensitive rates are used, then somewhat higher rates should apply to peak period traffic, with lower rates for non-peak usage." *Local Competition First Report and Order*, 11 FCC Rcd at 15878, para. 755. The Commission recognized that higher costs are incurred to carry additional traffic at peak volumes, because additional capacity is required to carry that traffic. *Id.* at 15878, para. 755. In contrast, "off-peak traffic imposes relatively little additional cost because it does not require any incremental capacity to be added to base plant." *Id.* at 15878, para. 755. The Commission found that there would be administrative difficulties with establishing peak-load prices, however, and did not require or forbid states from adopting that approach. *Id.* at 15878-79, paras. 756-57.

[444] *See generally Local Competition First Report and Order*, 11 FCC Rcd at 16008-58, paras. 1027-118 (implementing the reciprocal compensation obligations contained in section 251(b)(5) of the 1996 Act). The reciprocal compensation rules currently require the calling party's LEC to compensate the called party's LEC for the additional costs associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office, and for the additional costs of terminating the call to the called party. Section 51.701(c) of the Commission's rules defines transport as "the transmission and any necessary tandem switching of telecommunications traffic subject to section 251(b)(5) of the Act from the interconnection point between the two carriers to the terminating carrier's end office switch that directly serves the called party, or equivalent facility provided by a carrier other than an incumbent LEC." 47 C.F.R. § 51.701(c). Section 51.701(d) of the Commission's rules defines termination as "the switching of telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises." 47 C.F.R. § 51.701(d). In the *Local Competition First Report and Order*, the Commission also concluded that "the new

port and termination should "be recovered in a cost-causative manner and that usage based charges should be limited to situations where costs are usage sensitive."[445] In particular, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching" and that non traffic-sensitive costs, such as the costs of local loops and line ports, should not be considered "additional costs."[446] The Commission further found that the "additional costs" standard of section 252(d)(2) permits the use of the same TELRIC standard that it established for interconnection and unbundled elements.[447] The pric-

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transport and termination rules should be applied to LECs and CMRS providers." 11 FCC Rcd at 16016-17, para. 1043.

[445] *Local Competition First Report and Order*, 11 FCC Rcd at 16028, para. 1063. This determination led to per minute pricing for transport and termination, except in the case of dedicated facilities, which may be flat-rated. *Id.* at 16028, para. 1063. Specifically, the Commission required that all interconnecting parties be offered the option of purchasing dedicated facilities on a flat-rated basis. *Id.* at 16028, para. 1063.

[446] *Local Competition First Report and Order*, 11 FCC Rcd at 16024-25, para. 1057. Although the Commission concluded that "non-traffic sensitive costs should not be considered 'additional costs,'" the only non-traffic sensitive costs specifically identified and required to be removed were the costs of local loops and line ports. *Id.* at 16025, para. 1057.

[447] *Local Competition First Report and Order*, 11 FCC Rcd at 16023-25, paras. 1054-58. As with its pricing rules for UNEs, the Commission determined that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of forward-looking common costs. *Id.* at 16025, para. 1058. Similarly, the Commission again noted that the costs of transporting and terminating traffic during peak and off-peak hours may not be the same. *Id.* at 16028-29, para. 1064. In light of administrability concerns, the Commission once again neither required nor forbid states

ing rules governing reciprocal compensation that the Commission adopted in the *Local Competition First Report and Order* remain in effect today.[448]

173. Following passage of the 1996 Act, the Commission also began reforming both interstate access charges and federal universal service support mechanisms by moving the implicit subsidies contained in interstate access charges into explicit universal service support, consistent with the 1996 Act's directives. In particular, in the 1997 *Access Charge Reform Order*, the Commission modified the price cap rules for larger incumbent LECs by aligning the price cap LECs' rate structure more closely with the manner in which costs are incurred.[449] Recognizing Congress's direction that universal service

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from adopting rates that reflected peak and off-peak costs, but expressed hope that some states or negotiating parties would consider peak-load pricing. *Id.* at 16028-29, para. 1064.

[448] A number of parties appealed the Commission's *Local Competition First Report and Order*, including the rules it adopted governing the setting of rates for unbundled network elements and reciprocal compensation. In *AT&T v. Iowa Utilities Board*, the Supreme Court upheld the Commission's jurisdiction to "design a pricing methodology" to govern state rate setting under section 252 of the Act. *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999) (*AT&T v. Iowa Utils. Bd.*). Subsequently, in *Verizon Commc'ns, Inc. v. FCC*, the Supreme Court affirmed the Commission's choice of TELRIC as a permissible methodology for states to use in ratemaking proceedings. *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 497-529 (2002) (*Verizon v. FCC*). The court held that the Commission's decision to adopt a forward-looking cost methodology was a reasonable interpretation of the statute and that the Commission did not err in rejecting alternative methodologies advocated by the incumbent LECs. *Verizon v. FCC*, 535 U.S. at 507-08. The Court also rejected arguments that various aspects of the TELRIC methodology were unlawful. *Verizon v. FCC*, 535 U.S. at 523.

[449] *See Access Charge Reform Order*, 12 FCC Rcd at 16004-07, paras. 54-66 (summarizing the rate structure changes).

support should be "explicit," the Commission adopted rules to "reduce usage-sensitive interstate access charges by phasing out local loop and other non-traffic sensitive costs from those charges and directing incumbent LECs to recover those NTS [non-traffic sensitive] costs through more economically efficient, flat-rated charges."[450]

174. The Commission acknowledged, however, that the measures it adopted in the *Access Charge Reform Order* would not "remove all implicit support from all access charges immediately."[451] Rejecting suggestions that all implicit subsidies be eliminated from access charges immediately, the Commission noted that it did not have the tools to identify the existing subsidies precisely, and it expressed concern that eliminating all implicit subsidies at once might have an "inequitable impact on the incumbent LECs."[452] Moreover, while stating its desire to rely on competition to drive access charges toward cost,[453] the Commission recognized that "some services may prove resistant to competition," and it reserved the right to "adjust rates in the future to bring them into line with forward-looking costs."[454]

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[450] *Access Charge Reform Order*, 12 FCC Rcd at 15986, para. 6.

[451] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[452] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9; *see also id.* at 16002-03, paras. 45-47.

[453] Explaining its reliance on a "market-based" approach to access reform, it stated its belief that emerging competition in the local exchange markets would provide a more accurate means of identifying implicit subsidies and moving access rates to economically sustainable levels. *Access Charge Reform Order*, 12 FCC Rcd at 16001-02, para. 44.

[454] *Access Charge Reform Order*, 12 FCC Rcd at 16003, para. 48. The Commission also applied its market-based approach to the terminating access rates charged by competitive LECs and declined to

175. To limit possible rate shock to retail customers, the Commission also limited the amount of allocated interstate cost of a local loop that could be assessed directly on residential and business customers as a flat-rated monthly charge.[455] Although the *Access Charge Reform Order* started the process toward establishing explicit subsidies, the Commission concluded that "a proc-

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adopt any regulations governing competitive LEC access charges. *Id.* at 16141, para. 363. It reasoned that "the possibility of competitive responses by IXCs will have a constraining effect on non-incumbent LEC pricing." *Id.* at 16141, para. 362. This reliance on a market-based approach proved misplaced. In subsequent years, competitive LECs, instead of reducing access charges, frequently raised them above the regulated rates of incumbent LECs. As a result, the Commission was forced to regulate competitive LEC access charges. *See* 47 C.F.R. § 61.26; *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order, 16 FCC Rcd 9923, 9924, paras. 1-3 (2001) (*CLEC Access Charge Order*) (establishing benchmark rates for competitive LEC access charges), *recon.*, *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Petition of Z-Tel Commc'ns, Inc. For Temporary Waiver of Commission Rule 61.26(d) to Facilitate Deployment of Competitive Service in Certain Metropolitan Statistical Areas*, CC Docket No. 96-262, CCB/CPD File No. 01-19, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108 (2004) (*CLEC Access Charge Recon. Order*).

[455] *See, e.g.*, *Access Charge Reform Order*, 12 FCC Rcd at 16010-11, para. 73. To reduce per-minute carrier common line (CCL) charges, the Commission created the presubscribed interexchange carrier charge (PICC), a flat-rated, monthly charge imposed on IXCs on a per-line basis. *Id.* at 15998-16000, paras. 37-40. The Commission also shifted the cost of line ports from per-minute local switching charges to the common line category and established a mechanism to phase out the per-minute Transport Interconnection Charge (TIC). *Id.* at 16035-40, 16073-86, paras. 125-34, 210-43.

ess that eliminates implicit subsidies from access charges over time [was] warranted."[456]

176. In the 2000 *CALLS Order*,[457] the Commission continued its effort to remove implicit subsidies and replace them with explicit universal service support for price cap LECs by, among other things, reducing per-minute intercarrier charges, raising the SLC cap, phasing out the Presubscribed Interexchange Carrier Charge (PICC),[458] and permitting price-cap LECs to deaverage the SLC once the affected carrier charges were eliminated.[459] The Commission also created a new universal service fund to compensate price-cap incumbent LECs, in part, for lost interstate access revenues.[460]

177. In the *MAG Order*, the Commission extended similar reforms to incumbent LECs subject to rate-of-return regulation.[461] As with the *CALLS Order*, these re-

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[456] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[457] *See CALLS Order*, 15 FCC Rcd 12962.

[458] *See supra* note 455 (discussing the PICC).

[459] *See generally CALLS Order*, 15 FCC Rcd at 13025-28, paras. 151-59 (reducing interstate switched access rates); *id.* at 12991-13007, paras. 76-112 (raising SLC caps and eliminating PICCs); *id.* at 13007-14, paras. 113-28 (deaveraging SLCs).

[460] *See CALLS Order*, 15 FCC Rcd at 13046-49, paras. 201-05 (establishing a "$650 million interstate access universal service support mechanism").

[461] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carri-*

forms were designed to rationalize the interstate access rate structure by aligning it more closely with the manner in which costs are incurred.[462] Among other things, the *MAG Order* increased the SLC caps for rate-of-return carriers and phased out the per-minute CCL charge from the common line rate structure.[463] The Commission also created a universal service support mechanism to replace implicit support with explicit support, in order to foster competition and more efficient pricing.[464] Many, but not all, states have also addressed

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ers, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613 (2001) (*MAG Order*), *recon. in part*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon.*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003); *see also Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service*, CC Docket Nos. 00-256, 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004).

[462] *MAG Order*, 16 FCC Rcd at 19617, para. 3.

[463] *MAG Order*, 16 FCC Rcd at 19621, para. 15.

[464] *MAG Order*, 16 FCC Rcd at 19617, para. 3. A new universal service support mechanism, Interstate Common Line Support (ICLS), was implemented to replace the CCL charge beginning July 1, 2002. *Id.* at 19621, para. 15. This mechanism recovers any shortfall between the allowed common line revenue requirement of rate-of-return carriers and their SLC and other end-user revenues, thereby ensuring that changes in the rate structure did not affect the overall recovery of interstate access costs by rate-of-return carriers serving high-cost areas. *Id.* at 19642, 19667-73, paras. 61, 128-41. To reform

intercarrier compensation regulation. In addition to setting rates for reciprocal compensation, many states have revised their rules governing intrastate access charges. Although some states have chosen to mirror interstate access charges,[465] others continue to maintain intrastate access charges that far exceed interstate charges.[466]

3. Problems Associated With the Existing Intercarrier Compensation Regimes

178. The introduction of competition into local telephone markets revealed weaknesses in the existing intercarrier compensation regimes that remained notwithstanding the efforts of the Commission and certain states

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the local switching and transport rate structure of rate-of-return carriers, the Commission shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the TIC to other access rate elements, thus reducing per-minute switched access charges. *Id.* at 19649-61, paras. 76-111.

[465] *See, e.g., BA-WV's Intrastate Access Charges*, Case No. 00-0318-T-GI, Commission Order, 2001 WL 935643 (West Virginia PSC June 1, 2001) (ordering that "the traffic-sensitive intrastate access charges of Verizon-WV shall be modified to mirror the interstate rate structure and rate elements"); *Tariff Filing of BellSouth Telecommunications, Inc to Mirror Interstate Rates*, Case No. 98-065, Order (Kentucky PSC Mar. 31, 1999) (requiring BellSouth "to eliminate the state-specific Non-Traffic Sensitive Revenue Requirement . . . , thus moving its aggregate intrastate switched access rate to the FCC's 'CALLS' interstate rate"); *Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Order, 2007 WL 3023991 (Ohio PUC Oct. 17, 2007) ("[T]his Commission requires ILECs to mirror their interstate switched access rate on the intrastate side . . . .").

[466] *See, e.g.*, Letter from David C. Bartlett, Vice President of Federal Government Affairs, Embarq, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Exh. C (filed Aug. 1, 2008) (noting intrastate terminating switched access rates five to ten times higher than interstate rates in Missouri, Washington, Virginia, and several other States).

to reform interstate and intrastate access charges. As the Commission observed in 2001, "[i]nterconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation regulations . . . [that] treat different types of carriers and different types of services disparately, even though there may be no significant differences in the costs among carriers or services."[467] We have seen numerous examples of regulatory arbitrage in the marketplace both because of the different rates for similar functions under different intercarrier compensation regimes and because none of these regimes currently set rate levels in an economically efficient manner.[468]

179. One example of regulatory arbitrage involves traffic to dial-up ISPs. Following adoption of the *Local Competition First Report and Order*, state commissions set reciprocal compensation rates for the exchange of local traffic. These reciprocal compensation rates were sufficiently high that many competitive LECs found it profitable to target and serve ISP customers who were large recipients of local traffic, since dial-up Internet customers would call their ISP and then stay on the line for hours. This practice led to significant traffic imbalances, with competitive LECs seeking billions of dollars in re-

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[467] *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[468] The phrase "regulatory arbitrage" refers to profit-seeking behavior that can arise when a regulated firm is required to set difference prices for products or services with a similar cost structure. *See, e.g.*, PATRICK DEGRABA, BILL AND KEEP AT THE CENTRAL OFFICE AS THE EFFICIENT INTERCONNECTION REGIME 1, para. 2 n.3 (Federal Communications Commission, OPP Working Paper No. 33, 2000), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp33.pdf.

ciprocal compensation payments from other LECs.[469] The Commission responded by adopting a separate interim intercarrier compensation regime for this traffic.

180. On February 26, 1999, the Commission issued a Declaratory Ruling and Notice of Proposed Rulemaking in which it held that ISP-bound traffic is jurisdictionally interstate because end users access websites across state lines. Because the *Local Competition First Report and Order* concluded that the reciprocal compensation obligation in section 251(b)(5) applied to only local traffic, the Commission found in the *Declaratory Ruling* that ISP-bound traffic is not subject to section 251(b)(5).[470] On March 24, 2000, in the *Bell Atlantic* decision, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) vacated certain provisions of the *Declaratory Ruling*.[471] The court did not question the Commission's finding that ISP-bound traffic is interstate. Rather, the court held that the Commission had not adequately explained how its end-to-end jurisdictional analysis was relevant to determining whether a call to an ISP is subject to reciprocal compensation under section 251(b)(5).[472] In particular, the court noted that a LEC serving an ISP appears to perform the function of "termination" because the LEC delivers traffic from the call-

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[469] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9183, para. 70 (2001) (subsequent history omitted) (*ISP Remand Order*).

[470] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Declaratory Ruling and Notice of Proposed Rulemaking, 14 FCC Rcd 3689, 3703-06, paras. 21-27 (1999) (*Declaratory Ruling*), *vacated and remanded, Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

[471] *Bell Atlantic*, 206 F.3d at 1.

[472] *See Bell Atlantic*, 206 F.3d at 5.

ing party through its end office switch to the called party, the ISP.[473]

181. On April 27, 2001, the Commission released the *ISP Remand Order*, which concluded that section 251(g) excludes ISP-bound traffic from the scope of section 251(b)(5).[474] The Commission explained that section 251(g) maintains the pre-1996 Act compensation requirements for "exchange access, information access, and exchange services for such access," thereby excluding such traffic from the reciprocal compensation requirements that the 1996 Act imposed. The Commission concluded that ISP-bound traffic is "information access" and, therefore, is subject instead to the Commission's section 201 jurisdiction over interstate communications.[475] The Commission concluded that a bill-and-keep regime might eliminate incentives for arbitrage and force carriers to look to their own customers for cost recovery.[476] To avoid a flash cut to bill-and-keep, however, the Commission adopted an interim compensation regime pending

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[473] *Bell Atlantic*, 206 F.3d at 6.

[474] *See ISP Remand Order*, 16 FCC Rcd at 9171-72, para. 44.

[475] *See ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. Thus, the Commission affirmed its prior finding in the *Declaratory Ruling* that ISP-bound traffic is jurisdictionally interstate. *See id*; *see also Declaratory Ruling*, 14 FCC Rcd at 3701-03, paras. 18-20.

[476] *ISP Remand Order*, 16 FCC Rcd at 9184-85, paras. 74-75. The Commission discussed at length the market distortions and regulatory arbitrage opportunities created by the application of per-minute reciprocal compensation rates to ISP-bound traffic. In particular, the Commission found that requiring compensation for this type of traffic at existing reciprocal compensation rates undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers, thereby distorting the price signals sent to their ISP customers. *See id.* at 9181-86, paras. 67-76.

completion of the *Intercarrier Compensation* proceeding.[477]

182. On May 3, 2002, the D.C. Circuit found that the Commission had not provided an adequate legal basis for the rules it adopted in the *ISP Remand Order*.[478] Once again, the court did not question the Commission's finding that ISP-bound traffic is jurisdictionally interstate. Rather, the court held that section 251(g) of the Act did not provide a basis for the Commission's decision. The court held that section 251(g) is simply a transitional device that preserved obligations that predated the 1996 Act until the Commission adopts superseding rules, and there was no pre-1996 Act obligation with respect to intercarrier compensation for ISP-bound traffic.[479] Although the court rejected the legal rationale for the in-

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[477] *See ISP Remand Order*, 16 FCC Rcd at 9155-57, paras. 7-8. The interim regime adopted by the Commission consisted of: (1) a gradually declining cap on Intercarrier Compensation for ISP-Bound Traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use; (2) a growth cap on total ISP-bound minutes for which a LEC may receive this compensation; (3) a "new markets rule" requiring bill-and keep for the exchange of this traffic if two carriers were not exchanging traffic pursuant to an interconnection agreement prior to the adoption of the interim regime; and (4) a "mirroring rule" that gave incumbent LECs the benefit of the rate cap only if they offered to exchange all traffic subject to section 251(b)(5) at the same rates. *Id.* at 9187-89, 9193-94, paras. 78, 80, 89. In a subsequent order, the Commission granted forbearance to all telecommunications carriers with respect to the growth caps and the new markets rule. *See Petition of Core Comme'ns Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, Order, 19 FCC Rcd 20179 (2004) (*Core Forbearance Order*). Thus, only the rate caps and mirroring rule remain in effect today.

[478] *See WorldCom*, 288 F.3d at 429.

[479] *See WorldCom*, 288 F.3d at 433.

terim compensation rules, the court remanded, but did not vacate, the *ISP Remand Order* to the Commission, and it observed that "there is plainly a non-trivial likelihood that the Commission has authority" to adopt the rules.[480] Accordingly, the interim rules adopted in the *ISP Remand Order* have remained in effect.

183. On November 5, 2007, Core filed a petition for writ of mandamus with the D.C. Circuit seeking to compel the Commission to enter an order resolving the court's remand in the *WorldCom* decision.[481] On July 8, 2008, the court granted a writ of mandamus and directed the Commission to respond to the *WorldCom* remand in the form of a final, appealable order that "explains the legal authority for the Commission's interim intercarrier compensation rules that exclude ISP-bound traffic from the reciprocal compensation requirement . . . ."[482] The court directed the Commission to respond to the writ of mandamus by November 5, 2008.[483]

184. Another regulatory arbitrage opportunity arose as a result of the Commission's 1997 decision not to regulate the interstate access charges of competitive LECs. As a result, many competitive LECs filed tariffs with access charges that were well above the rates charged by incumbent LECs for similar services.[484] In response, the

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[480] *See WorldCom*, 288 F.3d at 434.

[481] Pet. for Writ of Mandamus, In re Core Communications Inc., No. 07-1446 (D.C. Cir. Nov. 5, 2007).

[482] *In re Core Commc'ns Inc.*, 531 F.3d 849, at 861-62 (D.C. Cir. 2008) (*Core Decision*).

[483] *See Core Decision*, 531 F.3d at 861-62. If the Commission fails to comply with the writ by the November 5th deadline, the interim rules will be vacated on November 6, 2008. *See id.* at 862.

[484] *See CLEC Access Charge Order*, 16 FCC Rcd at 9931, para. 22. For instance, the Commission found that certain competitive LECs

Commission adopted new rules that effectively capped the interstate access charges that competitive LECs could tariff.[485]

185. Two more recent examples of regulatory arbitrage involve billing problems and the "Access Stimulation" problem. Commenters describe problems billing for traffic when it arrives for termination with insufficient identifying information.[486] Because the existing intercarrier compensation mechanisms have vastly disparate rates that apply to different types of traffic, carriers have both the opportunity and incentive to disguise the nature, or conceal the source, of the traffic being sent in

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charged $0.09 per minute and that the weighted average of competitive LEC access rates was above $0.04 per minute. *Id.* In contrast, the same underlying data showed a composite incumbent LEC rate of $0.0056 for that same traffic. *See* AT&T Additional Comments, CC Docket Nos. 96-262, 97-146, CCB/CPD File No. 98-63, App. A. (Jan. 11, 2001). The Commission found that competitive LECs could impose excessive charges due to two factors. First, the Commission observed that access charges are paid by the IXC rather than the end-user customer. Because the IXC has no ability to affect the calling or called party's choice of service providers, it cannot avoid carriers with high access charges. *CLEC Access Charge Order*, 16 FCC Rcd at 9935, para. 31. Second, the Commission found that the rate averaging requirements in section 254(g) of the Act precluded IXCs from passing through particular competitive LECs' excessive access charges to the end user customers of those competitive LECs. *Id.* As a result, the Commission found the existing regulatory regime did not effectively create the incentives for the end users to select a lower-priced access provider. *Id.*

[485] *See* 47 C.F.R. § 61.26 (containing rules governing the tariffing of competitive LEC interstate switched exchange access services). As a general matter, the Commission's rules governing competitive LEC access charges limit these rates to those charged by the competing incumbent LEC. *Id.*

[486] *See infra* Part V.D.

order to avoid or reduce payments to other carriers.[487] "Access Stimulation" refers to allegations that certain LECs may have entered into agreements with providers of services that generate large volumes of incoming calls to substantially increase the number of calls sent to the LEC.[488] It has been alleged that this significantly increased "growth in terminating access traffic may be causing carriers' rates to become unjust or unreasonable" in violation of section 201 of the Act.[489] In the *Access Stimulation NPRM*, the Commission has sought information about the extent of this practice, its potential impact on the rates of price cap, rate-of-return, and competitive LECs, and how this practice should be addressed.[490]

B. Comprehensive Reform

1. Introduction

186. Evidence of increasing regulatory arbitrage, as well as increased competition and changes in technology, has led the Commission to consider comprehensive reform of intercarrier compensation. In 2001, the Commission adopted a Notice of Proposed Rulemaking to examine possible alternatives to existing intercarrier regimes with the intent of moving toward a more unified sys-

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[487] *See infra* para. 326.

[488] *See, e.g., Qwest Commc'ns Corp. v. Farmers and Merchs. Mut. Tel. Co.*, File No. EB-07-MD-001, Memorandum Opinion and Order, 22 FCC Rcd 17973, para. 1 (2007) (addressing Qwest's allegations that Farmers deliberately planned to "increase dramatically the amount of terminating access traffic delivered to its exchange, via agreements with conference calling companies").

[489] *See Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 17989, para. 1 (2007) (*Access Stimulation NPRM*).

[490] *Access Stimulation NPRM*, 22 FCC Rcd 17989

tem.[491] The notice generated extensive comments that generally confirmed the need for comprehensive intercarrier compensation reform, including a number of competing proposals.[492] In 2005, the Commission adopted

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[491] *See Intercarrier Compensation NPRM*, 16 FCC Rcd 9610. The Commission acknowledged a number of problems with the existing regimes, including inefficient rates and different rates for the same types of calls. *Id.* at 9616-18, paras. 11-18. The Commission thus sought comment on alternative approaches to reforming intercarrier compensation, including moving to a bill-and-keep approach to intercarrier compensation. *Id.* at 9611-13, paras. 2-4.

[492] *See, e.g.*, Regulatory Reform Proposal of the Intercarrier Compensation Forum (ICF Proposal), *attached to* Letter from Gary M. Epstein and Richard R. Cameron, Counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, App. A (filed Oct. 5, 2004) (ICF Oct. 5, 2004 *Ex Parte* Letter); Comprehensive Plan For Intercarrier Compensation Reform of Expanded Portland Group (EPG Proposal), *attached to* Letter from Glenn H. Brown, EPG Facilitator, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); Intercarrier Compensation Reform Plan of Alliance for Rational Intercarrier Compensation (ARIC Plan), *attached to* Letter from Wendy Thompson Fast, President, Consolidated Companies, and Ken Pfister, Vice President—Strategic Policy, Great Plains Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, 96-98, WC Docket No. 04-36 (filed Oct. 25, 2004); Cost-Based Intercarrier Compensation Coalition (CBICC Proposal), *attached to* Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 2, 2004); Updated Ex Parte of Home Telephone Company, Inc. and PBT Telecom (Home/PBT Proposal), *attached to* Letter from Keith Oliver, Vice President, Finance, Home Telephone Company, and Ben Spearman, Vice President, Chief Regulatory Officer, PBT Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); NASUCA Intercarrier Compensation Proposal at 1 (NASUCA Proposal), *attached to* Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 14, 2004); Western Wireless Intercarrier Compensation Reform Plan at 9 (Western

a Further Notice of Proposed Rulemaking seeking comment on the various industry proposals.[493] In 2006, another industry coalition submitted an alternative comprehensive intercarrier compensation reform proposal, known as the Missoula Plan.[494] The Commission separately requested and received comments on the Missoula Plan proposal.[495] Finally, in 2008, the Commission stabilized the universal service fund by adopting an interim cap on payments to competitive ETCs, helping pave the way for comprehensive intercarrier compensation and

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Wireless Proposal), *attached to* Letter from David L. Sieradzki, Counsel for Western Wireless Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 1, 2004).

[493] *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, 4687, para. 4 (2005) (*Intercarrier Compensation FNPRM*).

[494] *See* Missoula Plan for Intercarrier Compensation Reform (Missoula Plan), *attached to* Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, NARUC Task Force, and Larry Landis, Commissioner and Vice-Chair, NARUC Task Force, to Hon. Kevin Martin, Chmn., FCC, CC Docket No. 01-92 (filed July 24, 2006) (NARUC Task Force July 24, 2006 *Ex Parte* Letter).

[495] *Comment Sought on Missoula Intercarrier Compensation Reform Plan*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 8524 (2006). Subsequently, the Missoula Plan supporters filed additional details concerning specific aspects of the plan, on which the Commission continued to seek comment. *See Comment Sought on Missoula Plan Phantom Traffic Interim Process and Call Detail Records Proposal*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 13179 (2006); *Comment Sought on Amendments to the Missoula Plan Intercarrier Compensation Proposal to Incorporate a Federal Benchmark Mechanism*, CC Docket No. 01-92, Public Notice, 22 FCC Rcd 3362 (2007).

universal service reform, and leading to a number of new reform proposals.[456]

187. As a result of the *Intercarrier Compensation NPRM*, the *Intercarrier Compensation FNPRM*, the filing of the Missoula Plan, and the more recent proposals that have been filed, the Commission has compiled an extensive record over the past seven years. The Commission has received comments or proposals from a wide variety of interested parties, including, states, incumbent LECs, competitive LECs, rural companies, IXCs, new technology companies, consumer advocates, business customers, and industry associations. As demonstrated throughout this order, the Commission has thoroughly reviewed and analyzed the voluminous record, has considered the evidence submitted by the parties supporting the alternatives, and has carefully evaluated each of the proposals that have been presented. Based on this examination of the options, we find that the approach we describe below and adopt in this order best achieves the goals of promoting universal service, encouraging the efficient use of, and investment in, broadband technologies, spurring competition, and ultimately, further reducing the need for regulation.

2. A New Approach to Intercarrier Compensation

188. Since the introduction of competition into long-distance telephone service, the Commission has moved

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[456] The Commission invited parties to refresh the record in these and other relevant dockets. *Interim Cap Clears Path for Comprehensive Reform; Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

toward eliminating implicit subsidies from intercarrier charges. At every stage, however, the Commission has had to balance the desire to establish more efficient intercarrier charges against the potential adverse effects on consumers (in the form of higher flat-rated charges) and carriers (in the form of reduced intercarrier revenues). The introduction of competition into local telephone markets accelerated the need for reform. As discussed above, since the implementation of the 1996 Act, not only has local competition increased, but so has the incidence and severity of regulatory arbitrage.

189. We conclude today that, with the universal service fund now stabilized, we can wait no longer to begin the process of comprehensive intercarrier compensation reform. The differences in existing intercarrier compensation regimes impose significant inefficiencies on users and distort carriers' investment incentives, which can result in losses of billions of dollars in consumers and producers surplus. Possibly more important, these legacy regulatory regimes pose an obstacle to the transition to an all-IP broadband world. Because carriers currently can receive significant revenues from charging above-cost rates to terminate telecommunications traffic, they have a reduced incentive to upgrade their networks to the most efficient technology or to negotiate interconnection agreements that are designed to accommodate the efficient exchange of IP traffic, as both actions would likely lead to reduced intercarrier payments.[77]

190. In this order, we therefore adopt a new approach to intercarrier compensation and establish the blueprint

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[77] *See, e.g.*, T. Randolph Beard & George S. Ford, Do High Call Termination Rates Deter Broadband Deployment? (Phoenix Center Policy Bulletin No. 22, Oct. 2008), *available at* http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf.

for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we recognize, as the Commission has in the past, the need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan with separate stages, designed to reduce rates over a sufficient period to minimize market disruptions and to cushion the impact of our reform on both customers and carriers. At the end of the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

191. The requirements that we adopt for intercarrier compensation do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions. We find that these areas have very different attributes and related cost issues than the continental states.[498] For this reason, we are exempting providers in Alaska, Hawaii and U.S. Territories and possessions from the re-

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[498] *See, e.g., Verizon/América Móvil Transfer Order*, 22 FCC Rcd at 6211, para. 36 (describing "difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Rates and Services Integration Order*, 4 FCC Rcd at 396, paras. 7-8 (describing the unique market conditions and structure in Alaska); GCI Oct. 3, 2008 *Ex Parte* Letter (citing cost distinctions between Alaska and the continental United States).

quirements and rules adopted herein, and we will address them in a subsequent proceeding.[499]

192. *Transition Plan.* As described below, we adopt a ten-year transition plan.[500] In the first stage, intrastate access rates are reduced to the levels of interstate rates. During stage two, carriers will reduce their rates to an interim uniform termination rate, set by the state. Carriers whose current rates are below the interim uniform rate set by the state, however, may not increase their rates. During stage three, the rates carriers charge at the end of stage two (either the interim uniform rates or their prior rates, whichever are lower) will be gradually reduced to the rates that will apply at the end of the

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[499] *Cf. Policies and Service Rules for the Broadcasting-Satellite Service Order*, 22 FCC Rcd at 8860, para. 47 ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[500] A number of parties argue for a shorter transition period than that provided here. *See, e.g.*, Letter from Robert W. Quinn, Senior Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Oct. 23, 2008) (AT&T Oct. 23, 2008 *Ex Parte* Letter); Letter from Kyle McSlarrow, President and CEO, NCTA, to Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed Oct. 28, 2008) (NCTA Oct. 28, 2008 *Ex Parte* Letter); Letter from Paul W. Garnett, Assistant Vice-President, CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed October 27, 2008) (CTIA October 27, 2008 *Ex Parte* Letter); Small Business Administration Office of Advocacy (SBA) *ICC FNPRM* Comments at 5-7. We note that the reforms adopted today do not preclude carriers from entering into agreements that would reduce intercarrier charges more quickly, (*See, e.g.*, Letter from Susanne A. Guyer, Senior Vice-President, Verizon, to Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed October 28, 2008) at 6.) nor do they prevent state commissions from accelerating the glide path toward the final reciprocal compensation rate if they deem it appropriate.

transition. This transition will be designed by the state so as to minimize market disruptions and adverse economic effects. This transition is described in more detail below.

193. *Intrastate Rate Reductions.* One year from the effective date of this order, we require that all LECs reduce their terminating *intrastate* switched access rates by 50 percent of the difference between their intrastate switched access rates and their *interstate* switched access rates.[501] Two years from the effective date of this order, we require that all LECs reduce their terminating intrastate switched access rates by the remaining 50 percent of the difference between their intrastate switched access rates and their interstate switched access rates so that their intrastate rates equal their interstate rates. Carriers will comply with state tariffing requirements or other applicable state law in effectuating those changes in intrastate terminating access rates.

194. *State Establishment of Interim, Uniform Reciprocal Compensation Rates.* Within two years from the effective date of this order, states must adopt a statewide interim, uniform reciprocal compensation rate applicable to all carriers (except carriers whose rates are below the interim, uniform rate, in which case, those carriers' rates shall be capped at those lower, existing rates). Three years from the effective date of this order, we require that all LECs reduce their terminating rates by 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state. Four years from the effective date of this order we require that all LECs re-

[501] To the extent that a carrier's intrastate terminating access rate already is below its interstate terminating access rate, it will not change that rate.

duce their terminating rates by the remaining 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state so that their terminating rates equal the state-set interim, uniform reciprocal compensation rate. This rate will become the starting point for stage three—a six-year gradual downward transition to the final uniform reciprocal compensation rate, which the states will also set, consistent with the methodology we adopt in this order. The states will have discretion to determine the glide path, which begins four years from the effective date of this order and ends ten years from the effective date of this order. This glide path will determine the trajectory of the interim reciprocal compensation rate as it trends down to the final reciprocal compensation rate. All carriers are subject to this glide path. However, if a carrier's rate is below the rate specified in the glide path, such carrier cannot raise its rates, but is subject to the trajectory when the interim rate equals that carrier's rate. At the end of ten years (i.e., at the end of stage two), all the terminating rates of all carriers in each state will be reduced to the new final, uniform reciprocal compensation rate established by each state. We believe that, by establishing this ten-year, multiple-stage transition to a state-set final uniform reciprocal compensation rate, we will provide a sufficiently smooth and gradual glide path so that carriers will be able to adjust their other rates and revenues in a measured way over time, as allowed by the reforms adopted in this order, without creating unacceptable rate or revenue effects.

195. Although we permit the states to establish the particular interim, uniform reciprocal compensation rate for each step of the final six years of the transition, we establish certain conditions on the interim, uniform re-

ciprocal compensation rate and on the terminating intercarrier rates that carriers may charge. First, although we do not set forth a methodology that states must use in setting the interim, uniform reciprocal compensation rates, we do require that, within each state, there must be a single, state-wide interim, uniform reciprocal compensation rate during each year and at each stage of the transition.[502] Therefore, in establishing interim, uniform reciprocal compensation rates, a state may wish to consider the impact of those rates on all the carriers in the state. States are permitted to adopt an interim, uniform reciprocal compensation rate that may be higher at the beginning of the transition than some existing incumbent LEC rates today. If they do so, however, carriers with lower termination rates may not raise them to the interim uniform rate. Second, states may determine the glide path for moving from the interim, uniform reciprocal compensation rate to the final, uniform reciprocal compensation rate, subject to the requirement that the interim uniform rate be identical for all carriers at each step in the transition. By the end of the transition period, the interim, uniform reciprocal compensation rates must decrease to a single final, uniform reciprocal compensation rate for all carriers established pursuant to the Commission's new "additional costs" methodology.

196. *Transition of Rates During Stage Three.* Beginning four years from the effective date of this order, and through the remainder of the transition, each carrier must set each of its terminating rates at the lower of: (i) its current rate; or (ii) the state set interim, uniform re-

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[502] We recognize that the state-wide interim, uniform reciprocal compensation rates may vary state-by-state as state commissions consider the best means of transitioning to a final, uniform reciprocal compensation rate.

ciprocal compensation rate applicable at that stage of the transition. Thus, for example, if a carrier has an interstate terminating access rate above the interim, uniform reciprocal compensation rate applicable at that stage of the transition, but a current reciprocal compensation rate below the interim, uniform reciprocal compensation rate, the carrier will reduce its interstate rate to the interim rate but leave its current reciprocal compensation rate unchanged. That carrier will continue to have two separate termination rates until such time as the applicable interim, uniform reciprocal compensation rate is adjusted lower and becomes less than its current reciprocal compensation rate. At that time, all the carrier's rates will be set at the level of the interim, uniform reciprocal compensation rate for that state.

197. We emphasize that under no circumstances shall a carrier be permitted to increase its current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates. In this respect, the applicable interim, uniform reciprocal compensation rate set by the states will act as a ceiling or cap on such rates. We do not permit a carrier to charge a rate for terminating interstate or intrastate access, reciprocal compensation, or ISP-bound traffic that is higher than the interim, uniform reciprocal compensation rate, but we will permit a carrier to continue to charge a rate that is lower than the interim, uniform reciprocal compensation rate. We note that because CMRS providers may not tariff terminating access today,[503] and we do not per-

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[503] Although CMRS providers may not tariff access charges, they are not prohibited from entering into contracts with interexchange carriers that provide for the payment of such charges. *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling,

mit a carrier to increase rates during the transition, CMRS providers therefore will not be permitted to charge for terminating access until the end of the transition period.[504]

198. We note that we already have an interim intercarrier compensation regime for ISP-bound traffic, and to avoid disruption in the marketplace, we will apply on a transitional basis the pricing standards we adopted for ISP-bound traffic in the *ISP Remand Order*,[505] as modified by the *Core Forbearance Order*.[506] Currently, two rules remain in effect: (1) ISP-bound traffic is currently subject to a reciprocal compensation rate cap of $.0007 per minute-of-use; and (2) under the mirroring rule, the

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17 FCC Rcd 13192 (2002) (*CMRS Access Charges Declaratory Ruling*).

[504] Consistent with our conclusion that CMRS providers are unable to assess access charges during the transition, we make clear that our symmetry rule, set forth in Part V.C.1.b, will not apply until the transition is over. Even so, we clarify that, to the extent that any carrier has a terminating rate above the permissible rate, such carrier must reduce the rate to the permissible level. Specifically, in the first year of the transition, all carriers with intrastate access charges higher than their interstate access charges must reduce such charges by 50 percent of the difference between its interstate switched access rate and its intrastate switched access rate. Similarly, once the state-set interim, uniform rate is in effect, all carriers must reduce terminating rates, whether interstate access, reciprocal compensation, or ISP-bound traffic, by 50 percent of the difference between the current terminating switched access rate and the interim, uniform rate (as it is reduced over time). Even though rates during the transition will not reflect true symmetry, rates for most carriers should be symmetric before the transition is over as all carriers reduce charges to the final, uniform rate.

[505] *See ISP Remand Order*, 16 FCC Rcd at 9153, 9186-93, paras. 21, 77-88.

[506] *See Core Forbearance Order*, 19 FCC Rcd at 20184-89, paras. 16-26.

$.0007 cap applies to traffic exchanged with an incumbent LEC only if it offers to exchange all traffic subject to section 251(b)(5) at the same rate. As explained below, we conclude that it is appropriate to retain these rules, but only on a transitional basis until a state commission, applying the "additional costs" standards adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

199. In the *ISP Remand Order* in 2001, based on "convincing evidence in the record" that carriers had "targeted ISPs as customers merely to take advantage of . . . intercarrier payments"—offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud—the Commission adopted an interim ISP payment regime to "limit, if not end, the opportunity for regulatory arbitrage."[507] The Commission adopted a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use.[508] These rate caps reflected the downward trend in intercarrier compensation rates contained in then-recently negotiated interconnection agreements.[509] We have previously recognized that evidence that "carriers have agreed to rates"—through voluntary, arms-length negotiations—constitutes substantial evidence that rates are just and reasonable.[510]

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[507] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 77.

[508] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

[509] *ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85.

[510] *ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85; *see also Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, WC Docket No. 05-281, 22 FCC Rcd 1958, 1984-85, paras. 39, 40 n.136

200. Most commenters urge the Commission to maintain the interim compensation rules governing ISP-bound traffic until the Commission is able to transition to comprehensive intercarrier compensation reform.[511]

(2007) (finding that "commercially negotiated rates" provide "just and reasonable prices"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 98-147, 96-98, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17389, para. 664 (2003) (subsequent history omitted) (*Triennial Review Order*) (finding that "arms-length agreements . . . to provide [an] element at [a] rate" "demonstrate[s]" that the rate is "just and reasonable").

[511] *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 10 (filed July 8, 2008) (asking the Commission to maintain the existing compromises reached with respect to ISP-bound traffic); Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68 at 8 (filed May 9, 2008) (asserting that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform); Letter from L. Charles Keller, Counsel for Sage Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 99-68, 01-92, Attach. at 6 (Sage Telecom May 9, 2008 *Ex Parte* Letter) (stating that retaining the ISP rate serves broad policy goals); Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 1 (filed May 7, 2008) (supporting continuation of the interim compensation rules); Letter from Joshua Seidmann, Vice President of Regulatory Affairs, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 2 (filed Apr. 28, 2008) (ITTA Apr. 28, 2008 *Ex Parte* Letter) (asking the Commission to retain the current $0.0007 rate for ISP-bound traffic); Letter from Donna Epps, Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 at 1 (filed Apr. 7, 2008) (urging the Commission to support its earlier finding that $0.0007 is appropriate compensation for dial-up ISP

These parties contend that a higher compensation rate would create new opportunities for arbitrage[512] and impose substantial financial burdens on wireless companies, incumbent LECs and state public utility commissions.[513] They further claim that the existing regime has simplified interconnection negotiations.[514]

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traffic); Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, Attach. (filed May 1, 2008) (describing how elimination of the existing ISP rate would create substantial burdens on a number of carriers and state commissions) (Verizon Wireless May 1, 2008 *Ex Parte* Letter); Letter from Glenn Reynolds, Vice President, Policy, US-Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-262, WC Docket No. 07-135 at 2 (filed Apr. 29, 2008) (noting that the Commission's existing rules have "largely mitigated the debate around compensation for ISP-bound traffic, but there is every reason to believe the same problems would arise if the Commission were to reverse direction on this issue") (USTelecom Apr. 29, 2008 *Ex Parte* Letter).

[512] *See, e.g.*, USTelecom Apr. 29, 2008 *Ex Parte* Letter at 2; Letter from Melissa E. Newman, Vice President, Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, WC Docket No. 07-135, Attach. at 3-5 (filed Apr. 25, 2008) (Qwest April 25, 2008 *Ex Parte* Letter); Verizon and BellSouth, Further Supplemental White Paper on ISP Reciprocal Compensation at 20 (Verizon/BellSouth Further Supp. ISP White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004).

[513] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter, Attach.

[514] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter (stating that "the [m]irroring [r]ule simplified wireless-ILEC interconnection negotiations tremendously."); Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Docket Nos. 01-92, 96-98, 99-68 at 38-40 (filed Oct. 2, 2008) (Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments) (indicating that Verizon entered into multiple

201. We share these commenters' concerns. The record also suggests that eliminating the $.0007 cap and instead applying higher reciprocal compensation rates that may be set by the states during the transition period to the adoption of our new methodology would have a significant negative impact on carriers serving rural markets and broadband deployment.[515] The record demonstrates that dial-up minutes remain at high levels in rural areas and that the application of reciprocal compensation to these minutes would generate significant costs to carriers serving these rural areas.[516] Thus, it remains the case that the "rate caps help avoid arbitrage

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agreements using the $.0007 rate cap established in the *ISP Remand Order*).

[515] *See, e.g.*, ITTA April 28, 2008 *Ex Parte* Letter, Attach. at 3, 5; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 2, 5-7.

[516] *See, e.g.*, Letter from Tamar E. Finn, Counsel for Earthlink, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at iii, 11-12 (filed Aug. 14, 2008) (estimating that 24% of dial-up users in rural America say that broadband service is not available where they live); Sage Telecom May 9, 2008 *Ex Parte* Letter at 3-4; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 6 (calculating its cost to be $100 million if all ISP-bound minutes were subject to TELRIC-based rates under section 251(b)(5)); ITTA Apr. 28, 2008 *Ex Parte* Letter (noting that dial-up usage remains strong in rural areas); USTelecom Apr. 29, 2008 *Ex Parte* Letter (noting a "recent study from the Pew Internet & American Life Project that indicated that while the number of dial-up subscribers had dropped 63% since 2001, the number of minutes spent online by each dial-up subscriber had increased approximately 70%. As a result, some USTelecom member companies are actually seeing an *increase* in dial-up minutes.") (emphasis in original); Letter from Bennett L. Ross, General Counsel—D.C., BellSouth D.C., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 03-171 (filed Aug. 29, 2005) (attaching a chart showing that "dial-up subscribers would continue to generate substantial minutes of dial-up ISP calls, notwithstanding projections of a continued decline in the number of dial-up subscribers.").

and market distortions that otherwise would result from the availability of reciprocal compensation for ISP-bound traffic."[517] We further believe that maintaining the cap on a transitional basis will minimize the disruptive effects and regulatory uncertainty that otherwise would result from the abrupt elimination of clear compensation rules for ISP-bound traffic.

202. We expect that state commissions, applying the new "additional costs" standard adopted in this order, will set final reciprocal compensation rates at or below $.0007 per minute-of-use. As noted below, the evidence in the record suggests that the incremental cost of call termination on modern switches is de minimis.[518] We have given state commissions up to ten years to transition to new rates based on the "additional costs" standard. Accordingly, the rate cap will only have an impact in a particular state on a transitional basis until that state sets rates at or below $.0007.

203. The mirroring rule has also succeeded in promoting the Commission's "goal of a more unified intercarrier compensation regime by requiring LECs to offer similar rates for like traffic."[519] Most intraMTA traffic is now exchanged pursuant to the rate caps, and a substantial portion of wireline intraexchange traffic is being exchanged at rates at or below the rate caps as well.[520] Eliminating the mirroring rule and allowing carriers to charge higher transitional reciprocal compensation rates for traffic currently subject to the mirroring rule would

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[517] *Core Forbearance Order*, 19 FCC Rcd at 20815-16, para. 18.

[518] *See supra* para. 255.

[519] *Core Forbearance Order*, 19 FCC Rcd at 20816, para. 19.

[520] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

significantly increase the cost carriers incur in exchanging that traffic. Those increased costs would divert funds from investment in next generation wireless networks and likely would be borne by consumers, through increases in the costs of wireless offerings.[521]

204. We reject arguments that the Commission unlawfully delegated its authority in the *ISP Remand Order* and arguments that the Commission addressed previously in the *Core Forbearance Order*.[522] We also disagree with parties who suggest that the Commission, in responding to the D.C. Circuit's remand in *WorldCom*, must offer detailed new justifications for each of the four features of the ISP intercarrier payment regime: the rate caps, the mirroring rule, the growth cap, and the new markets rule.[523] The prior policy justifications offered for those rules by the Commission have not been overturned by any court, and our current policy justification for retaining these rules is simply to maintain the status quo in

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[521] Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

[522] *See* Letter from Michael B. Hazzard, Counsel for Core Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at 18 & n.8 (filed May 14, 2008) (Core May 14, 2008 *Ex Parte* Letter). We also reject Core's argument that the *ISP Remand Order* unlawfully delegates to incumbent LECs the decision of whether the *ISP Remand Order* applies. *See id.* at 19-20. The Commission did not delegate its authority in the *ISP Remand Order* but rather provided options that were not mandatory. *See, e.g.*, *ISP Remand Order*, 16 FCC Rcd at 9193, para. 89. Additionally, Core argues that the Commission provided no reasoned explanation for the growth cap and new market rules adopted in the *ISP Remand Order* and never provided notice or an opportunity for comment on those specific rules. These rules, as applicable to all carriers, were forborne from in the *Core Forbearance Order*. *See Core Forbearance Order*, 19 FCC Rcd at 20186-87, paras. 20-21. As such, this argument is moot.

[523] *See* Core May 14, 2008 *Ex Parte* Letter, Attach. at 20-26.

this area on a transitional basis until our new "additional costs" methodology has been fully implemented. Indeed, pursuant to our new "additional costs" methodology, we believe that the rate caps set forth in 2001 may well be higher than the final, uniform reciprocal compensation rates set by the states. However, discarding these rules during the transition to our new methodology would be unwise and unwarranted because the "rate caps are necessary to prevent discrimination *between* dial-up Internet access customers and basic telephone service customers," those caps "protect consumers of basic telephone service" from being forced to subsidize dial-up Internet access service, and the rate caps minimize the "classic regulatory arbitrage" that reciprocal compensation for ISP-bound traffic had made possible.[524]

205. In sum, we maintain the $.0007 cap and the mirroring rule, on a transitional basis, pursuant to our section 201 authority. These interim rules shall remain in place in a state until the state commission, applying the "additional costs" standard adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

206. We find that our transition plan is necessary and appropriate to prevent undue economic hardships to carriers caused by a too-rapid reduction in intercarrier compensation rates. If there is evidence that carriers are attempting to abuse the interim, uniform reciprocal compensation rate and/or transition process to create arbitrage opportunities, we encourage carriers to bring such evidence to our attention or that of the state commission

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[524] *In re Core Comme'ns*, 455 F.3d at 277-80 (internal quotation marks omitted).

so such claims can be investigated and, if appropriate, action taken.

3. Legal Authority

a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g)

207. The history of intercarrier compensation reveals many policy reasons for comprehensively reforming intercarrier compensation rates, including reducing arbitrage, promoting competition, facilitating the introduction of new technologies, and benefiting consumers. The dual structure of separate federal and state jurisdiction over communications has made accomplishing such reforms more complex, however. Although our reform does not disturb those fundamental jurisdictional distinctions, we find that, through the tools made available by the 1996 Act, we have the means to accomplish this reform by electing to partner with the states.

208. The Commission unquestionably has authority to reform intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and IP/PSTN traffic. Section 2(a) of the Act establishes the Commission's jurisdiction over interstate services, for which the Commission ensures just, reasonable, and not unjustly and unreasonably discriminatory rates under section 201 and 202.[525] Likewise, the Commission has authority over the rates of CMRS providers pursuant to section 332 of the Act.[526] We also make clear that authority to impose economic regulation with respect to IP/PSTN traffic rests exclusively with this Commission. The Commission has adopted a number of regulatory re-

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[525] 47 U.S.C. §§ 152(a), 201, 202.

[526] 47 U.S.C. § 332.

quirements applicable to interconnected VoIP services and providers.[527] With respect to the statutory classification of IP-enabled services, however, the Commission only has addressed two situations.[528]

209. We now classify as "information services" those services that originate calls on IP networks and termi-

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[527] *See, e.g., Telephone Number Requirements for IP-Enabled Services Providers; Local Number Portability Porting Interval and Validation Requirements; IP-Enabled Services; CTIA Petitions for Declaratory Ruling on Wireline-Wireless Porting Issues*, CC Docket Nos. 99-200, 95-116, WC Docket Nos. 07-243, 07-244, 04-36, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, 19538-40, paras. 14, 16 (2008) (*LNP Order*) (imposing LNP requirements, and noting that the Commission previously imposed the requirement to provide 911 service, to contribute to universal service, to protect the privacy of customers, to comply with disability access and telecommunications relay service requirements, and to satisfy certain CALEA obligations).

[528] On one hand, the Commission classified as an "information service" Pulver.com's free service that did not provide transmission and offers a number of computing capabilities. *Petition for Declaratory Ruling that Pulver.com's Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, WC Docket No. 03-45, Memorandum Order and Opinion, 19 FCC Rcd 3307 (2004) (*Pulver.com Order*). On the other hand, the Commission found that certain "IP-in-the-middle" services were "telecommunications services" where they: (1) use ordinary customer premises equipment (CPE) with no enhanced functionality; (2) originate and terminate on the public switched telephone network (PSTN); and (3) undergo no net protocol conversion and provide no enhanced functionality to end users due to the provider's use of IP technology. *See, e.g., Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 (2004) (*IP-in-the-Middle Order*). *See also, e.g., Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290 (2006) (*Prepaid Calling Card Order*).

nate them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks (collectively "IP/PSTN" services).[529] Such traffic today involves a net protocol conversion between end-users, and thus constitutes an "enhanced" or "information service."[530]

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[529] We use the term "IP/PSTN" as a shorthand, without reaching any universal conclusions regarding the technology underlying the PSTN. Today the PSTN continues to rely primarily on circuit-switched technology to connect to end-user customers, although we recognize that carriers increasingly are converting portions of their networks to IP technology. *See, e.g., IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers*, WC Docket Nos. 04-36, 05-196, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, 10258, para. 24 & n.77 (2005) (distinguishing the "specialized" CPE required for interconnected VoIP services from the standard CPE used for typical telephone calls); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11532, para. 84 (1998) ("'IP telephony' services enable real-time voice transmission using Internet protocols. The services can be provided in two basic ways: through software and hardware at customer premises, or through 'gateways' that enable applications originating and/or terminating on the PSTN. Gateways are computers that transform the circuit-switched voice signal into IP packets, and vice versa, and perform associated signaling, control, and address translation functions."). Insofar as a service allows a customer to originate a communication on an IP network and terminate it on a circuit-switched network, or vice versa, it involves a net protocol conversion, and we classify it as an "information service" today. Insofar as that service allows communications with no net protocol conversion, it is not subject to our "information service" classification here. We note that the presence of a net protocol conversion is not the only basis for classifying a service as an "enhanced" or "information service." *See, e.g.*, 47 C.F.R. § 64.702(a); *Computer II Final Decision*, 77 FCC 2d at 420-21, para. 97. We do not reach those issues at this time, however.

[530] *See, e.g., Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, First Report and Order and Fur-

210. Although there are certain exceptions to this treatment, we do not find them applicable.[531] In particular, we do not find this to be "protocol conversion in connection with the introduction of new technology to implement existing services" that would be treated as a "basic," rather than "enhanced" service.[532] That excep-

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ther Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21957-58, para. 106 (1996) (*Non Accounting Safeguards Order*). Interpreting the 1996 Act's definition of "information services," the Commission held that "all of the services that the Commission has previously considered to be 'enhanced services' are 'information services.'" *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21956, para. 103. For the all reasons discussed in Part V.B.2, we decline to defer the classification of IP/PSTN services, as requested by some parties, instead finding it appropriate to address this issue as part of our comprehensive reforms. *See, e.g.*, Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, CC Docket Nos. 96-45, 01-92 at 15 (filed Oct. 24, 2008) (Free Press Oct. 24, 2008 *Ex Parte* Letter); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Broadview Networks, et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008).

[531] Two of the exceptions are: (1) protocol processing involving communications between an end user and the network itself (*e.g.*, for initiation, routing, and termination of calls) rather than between or among users; and (2) protocol conversion to facilitate the interconnection of networks. *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957-58, para. 106. These categories of protocol processing services may involve protocol conversions, but they result in no net protocol conversion between the end users. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, Order on Reconsideration, 12 FCC Rcd 2297, 2297-99, para. 2 (1997). Thus, they are not relevant here.

[532] *Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Phase II Carrier Service and Facilities Authorization Thereof; Communications Protocols Under Section 64.702 of the Commission's Rules and Regulations*,

tion was designed to address situations "involving no change in an existing service, but merely a change in electrical interface characteristics to facilitate transitional introduction of new technology."[533] By contrast, we find that IP/PSTN services are not mere changes to the underlying technology used for "existing" basic services, but are entirely new services with characteristics in many ways distinct from preexisting telephone services.[534]

CC Docket No. 85-229, Report and Order, 2 FCC Rcd 3072, 3081, para. 65 (1987) (*Computer III Phase II Order*). *See also Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957-58, para. 106.

[533] *Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, GN Docket No. 80-756, Memorandum Opinion, Order, and Statement Of Principles, 95 FCC 2d 584, para. 16 (1983) (*Protocols Order*).

[534] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 9-11 (filed Sept. 19, 2008); Letter from Susanne A. Guyer, Senior Vice President, Federal Regulatory Affairs, Verizon, to Chairman Kevin J. Martin, FCC, WC Docket No. 04-36, at 10-11 (filed Aug. 6, 2007); Letter from AT&T et al., to Chairman Kevin J. Martin, FCC, et al., WC Docket No. 04-36, CC Docket No. 01-92 at 2-3 (filed Aug. 6, 2008); VON Coalition *IP-Enabled Services NPRM* Comments at 3-16; AT&T *IP-Enabled Services NPRM* Comments at 13-17. We thus disagree with parties who suggest, in essence, that IP/PSTN services are no different than "basic" services. *See, e.g.*, Letter from Thomas Jones and Jonathan Lechter, Counsel for tw telecom et al., to Marlene H Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 99-68, 04-36, Attach. at 2 (filed Oct. 28, 2008) (tw telecom *et. al* Oct. 28, 2008 *Ex Parte* Letter). We note that whether a service is viewed by consumers as a possible substitute for a "basic" service is a distinct question from whether, as a matter of technology and the nature of the service offering, the service simply replaces the technology underlying a preexisting basic service. Thus, our conclusion here is not inconsistent with the Commission's recognition that interconnected VoIP services increasingly are

211. Consistent with the *Pulver.com Order* and the *Vonage Order*, we preempt any state efforts to impose "traditional 'telephone company' regulations" as they relate to IP/PSTN information services as inconsistent with our generally unregulated treatment of information services.[535] Of course, neither the *Vonage Order*, the *Pulver.com Order*, nor our actions here preempt state actions that are consistent with federal policy.[536] Moreover, as we describe below, we allow states to establish reciprocal compensation rates, pursuant to our methodology, including for IP/PSTN traffic.

212. In sections 251 and 252 of the Act, Congress altered the traditional regulatory framework based on jurisdiction by expanding the applicability of national rules to historically intrastate issues and state rules to historically interstate issues.[537] In the *Local Competition First*

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viewed by consumers as a substitute for traditional telephone services. *See, e.g., LNP Order*, 22 FCC Rcd at 19547, para. 28.

[535] *Vonage Order*, 19 FCC Rcd at 22404; *see also Pulver.com Order*, 19 FCC Rcd at 3316, para. 15 ("We determine, consistent with our precedent regarding information services, that FWD is an unregulated information service and any state regulations that seek to treat FWD as a telecommunications service or otherwise subject it to public-utility type regulation would almost certainly pose a conflict with our policy of nonregulation.").

[536] For example, states are free to require contributions to state universal service or telecommunications relay service funds through methodologies that are consistent with federal policy. *See, e.g.*, Letter from Robert W. Quinn, Jr. Senior Vice President, Federal Regulatory, AT&T, to Chairman Kevin J. Martin, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 96-45 at 11-16 (filed July 23, 2008) (describing ways that states could require contributions to state universal service or telecommunications relay service funds in a manner that is consistent with federal policy).

[537] *See Local Competition First Report and Order*, 11 FCC Rcd at 15544, para. 83.

Report and Order, the Commission found that the 1996 Act created parallel jurisdiction for the Commission and the states over interstate and intrastate matters under sections 251 and 252.[538] The Commission and the states "are to address the same matters through their parallel jurisdiction over both interstate and intrastate matters under sections 251 and 252."[539] Moreover, section 251(i) provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[540] The Commission concluded that section 251(i) "affirms that the Commission's preexisting authority under section 201 continues to apply for purely interstate activities."[541]

213. In implementing sections 251 and 252 in the *Local Competition First Report and Order*, the Commission's treatment of LEC-CMRS traffic provides an instructive approach. Prior to the 1996 Act, the Commission expressly preempted "state and local regulations of the kind of interconnection to which CMRS providers are entitled" based on its authority under section 201 and 332 of the Act.[542] Nevertheless, in the *Local Competition First Report and Order*, the Commission brought LEC-CMRS interconnection within the section 251 framework as it relates to intraMTA (including interstate intraMTA)

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[538] *Local Competition First Report and Order*, 11 FCC Rcd at 15544-45, para. 85.

[539] *Local Competition First Report and Order*, 11 FCC Rcd at 15546-47, para. 91.

[540] 47 U.S.C. § 251(i).

[541] *Local Competition First Report and Order*, 11 FCC Rcd at 15546-47, para. 91.

[542] *Implementation of Sections 3(n) and 332*, Second Report and Order, 9 FCC Rcd 1411, 1498, para. 230 (1994).

traffic.[543] The Commission recognized, however, that it continued to retain separate authority over CMRS traffic.[544]

214. Courts confirmed that, in permitting LEC-CMRS interconnection to be addressed through the section 251 framework, the Commission did not in any way lose its independent jurisdiction or authority to regulate that traffic under other provisions of the Act. Thus, although the Eighth Circuit invalidated the Commission's TELRIC pricing rules in general,[545] it recognized that "because section 332(c)(1)(B) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers, [including the reciprocal compensation rules] but only as these provisions apply to CMRS providers. Thus, [the pricing] rules . . . remain in full force and effect with respect to the CMRS providers, and our order of vacation does not apply to them in the CMRS context."[546] Subsequently, the D.C. Circuit held that CMRS providers were entitled to pursue formal complaints under section 208 of

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[543] *See Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023.

[544] *Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023 ("By opting to proceed under sections 251 and 252, we are not finding that section 332 jurisdiction over interconnection has been repealed by implication, or rejecting it as an alternative basis for jurisdiction.").

[545] We note that the Supreme Court later reversed this decision and affirmed the TELRIC methodology. *See Verizon v. FCC*, 535 U.S. at 467.

[546] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (*Iowa Utils. I*), *rev'd in part and remanded on other grounds*, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366.

the Act for violations of the Commission's reciprocal compensation rules.[547]

215. We build upon our actions in the *Local Competition First Report and Order*, and now permit states to establish a uniform reciprocal compensation rate, in accordance with the new methodology we establish in this order, pursuant to the section 251(b)(5) and 252(d)(2) framework. In particular, section 251(b)(5) imposes on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[548] Section 252(d)(2)(A) sets forth an "additional costs" standard that state commissions, in arbitrating interconnection disputes involving incumbent LECs, should apply in setting the "charges for transport and termination of traffic."[549] Although we allow states to set new uniform termination rates under this framework, pursuant to our methodology, we retain our authority under section 201 to find that reciprocal compensation charges are unjust and unreasonable as they relate to interstate, CMRS, and IP/PSTN traffic within our jurisdiction.[550] We expect that states will faithfully implement

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[547] *Qwest Corp. v. FCC*, 252 F.3d 462, 465-66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. I* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion).

[548] 47 U.S.C. § 251(b)(5).

[549] 47 U.S.C. § 252(d)(2)(A).

[550] *See supra* paras. 208-14. *See also, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92 at 9-11 (filed on Aug. 18, 2008) (Level 3 Aug. 18, 2008 *Ex Parte* Letter). Contrary to Verizon's claims, we thus find no tension between permitting states to set reciprocal compensation rates for interstate traffic under the section 251 and 252 framework and the Commission's continuing authority

the pricing standards adopted in this order, and thus it will not be necessary for us to exercise that authority.[551]

216. The Commission unquestionably has authority to interpret and adopt rules implementing sections 251(b)(5) and 252(d)(2). Congress delegated to the Commission the task of administering the Communications Act. Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[552] "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'"[553] The Commission's rulemaking authority is not limited to interstate matters; it extends to all provisions of the Communications Act.[554]

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over traffic subject to its jurisdiction, including section 201 authority expressly preserved under section 251(i).

[551] We recognize that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking." *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and *Order*, 12 FCC Rcd 16606, 16619-20, para. 44 (*Access Charge Reform Second Order*) (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)). In this order, we adopt an incremental cost methodology for setting termination rates. We find that the proper application of that methodology produces rates that are "just and reasonable" under section 201. As discussed below, we find it appropriate to adopt a transition before carriers begin charging rates set pursuant to our incremental cost methodology.

[552] 47 U.S.C. § 201(b) ("The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.").

[553] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378.

[554] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the

217. In addition, we find that the section 251(b)(5) and 252(d)(2) framework is broad enough to facilitate our intercarrier compensation reform. We acknowledge that, in the *Local Competition First Report and Order*, the Commission found that section 251(b)(5) applies only to local traffic,"[555] and some commenters continue to press for such an interpretation.[556] As other commenters recognize, however, the Commission, in the *ISP Remand Order*, reconsidered that judgment and concluded that it was a mistake to read section 251(b)(5) as limited to local traffic, given that "local" is not a term used in section 251(b)(5).[557] We recognize, as the Supreme Court noted

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regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

[555] *Local Competition First Report and Order*, 11 FCC Rcd at 16012-13, para. 1033.

[556] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24-32; Letter from Daniel Mitchell, Vice President, Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9 (filed Sept. 30, 2008) (NCTA Sept. 30, 2008 *Ex Parte* Letter); Verizon *ICC FNPRM* Comments at 38-42; NARUC *ICC FNPRM* Comments at 6-7; Rural Alliance *ICC FNPRM* Comments at 144-49; Cincinnati Bell *ICC FNPRM* Comments at 5-11; Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7; New York State PSC *ICC FNPRM* Comments at 7; Verizon and BellSouth, Supplemental White Paper on ISP Reciprocal Compensation, CC Docket No. 96-98, 99-68 at 16-20 (filed July 20, 2004) (Verizon/BellSouth Supp. ISP White Paper); NARUC's Initial Comments at 7 n.13 (May 23, 2004). *But see, e.g.*, ICF *ICC FNPRM* Comments at 39.

[557] *ISP Remand Order*, 16 FCC Rcd at 9166-67, para. 35. *See also, e.g.*, Qwest, Legal Authority for Comprehensive Intercarrier Compensation Reform at 2-4, *attached to* Letter from Melissa Newman, Counsel for Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 06-45, 99-68, WC Docket Nos. 04-36, 05-337, 05-195, 06-122 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Counsel for T-Mobile, to Marlene H. Dortch, Secretary, FCC,

in *AT&T Corp. v. Iowa Utilities Board*, that "[i]t would be a gross understatement to say that the 1996 Act is not a model of clarity."[558] Nevertheless, we find that the better view is that section 251(b)(5) is not limited to local traffic.

218. We begin by looking at the text of the statute. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[559] The Act broadly defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[560] Its scope is not limited geographically ("local," "intrastate," or "interstate") or to particular services ("telephone exchange service,"[561] telephone toll service,"[562] or "exchange access"[563]). We find that the traffic we elect to bring within this framework fits squarely within the meaning of "telecommunications."[564] Had Con-

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CC Docket No. 01-92 at 9-10 (filed Oct. 3, 2008); Level 3 Aug. 18, 2008 *Ex Parte* Letter at 2, 15-18; AT&T *Missoula Phantom Traffic* Reply at 35-41; Brief from Gary M. Epstein, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 29-35 (filed Oct. 5, 2004)

[558] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 397.

[559] 47 U.S.C. § 251(b)(5).

[560] 47 U.S.C. § 153(43).

[561] *Id.* at § 153(47).

[562] *Id.* at § 153(48).

[563] *Id.* at § 153(16).

[564] As discussed above, we classify IP/PSTN services as "information services." We note, however, that information services, by definition, are provided "via telecommunications," enabling us to bring IP/PSTN traffic within the section 251(b)(5) framework. 47 U.S.C. § 153(20). Moreover, given that we retain independent authority

gress intended to preclude the Commission from bringing certain types of telecommunications traffic within the section 251(b)(5) framework, it could have easily done so by incorporating restrictive terms in section 251(b)(5). Because Congress used the term "telecommunications," the broadest of the statute's defined terms, we conclude that section 251(b)(5) is not limited only to the transport and termination of certain types of telecommunications traffic, such as local traffic.

219. In the *Local Competition First Report and Order* the Commission concluded that section 251(b)(5) applies only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge."[165] In the *ISP Remand Order*, the Commission reversed course on the scope of section 251(b)(5), finding that "the phrase 'local traffic' created unnecessary ambiguities, and we correct that mistake here."[166] The *ISP Remand Order* noted that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)."[167] The Commission found that the scope of section 251(b)(5) is limited only by section 251(g), which temporarily grandfathered the pre-1996 Act rules

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under section 201, we find it reasonably ancillary to that authority to regulate IP/PSTN services in this regard, consistent with our efforts to ensure uniform treatment of all traffic on the PSTN for intercarrier compensation purposes. Thus, IP/PSTN traffic ultimately will be subject to the final uniform reciprocal compensation rates established pursuant to the methodology adopted in this order. We maintain the status quo for this traffic during the transition, however.

[165] *Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033.

[166] *ISP Remand Order*, 16 FCC Rcd at 9173, para. 46.

[167] *ISP Remand Order*, 16 FCC Rcd at 9167, para. 34.

governing "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers until "explicitly superseded by regulations prescribed by the Commission."[568] On appeal, the D.C. Circuit left intact the Commission's findings concerning the scope of section 251(b)(5), although it took issue with other aspects of the *ISP Remand Order*.[569]

220. We agree with the finding in the *ISP Remand Order* that traffic encompassed by section 251(g) is excluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope. Section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation."[570] There would have been no need for Congress to have preserved these compensation rules against the effects of section 251 if the scope of section 251(b)(5) was not broad enough for the Commission to bring within its scope the traffic covered by section 251(g), i.e., access traffic. Because Congress is presumed not to have wasted its breath, particularly with a provision as lengthy and detailed as section 251(g), we find that section 251(g) confirms that section 251(b)(5) applies to the transport and termination of all telecommunications traffic exchanged with LECs, including ISP-bound traffic. And because section 251(g) "is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the

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[568] 47 U.S.C. § 251(g).

[569] *See WorldCom*, 288 F.3d at 429.

[570] 47 U.S.C. 251(g).

Act,"[571] we clearly have authority under the Act to adopt regulations superseding that regime. We exercise that authority today.[572]

221. By placing all traffic under the umbrella of one compensation scheme, we eliminate jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions.[573] Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis. These artificial distinctions distort the telecommunications markets at the expense of healthy competition. Similar types of traffic should be subject to similar rules. Similar types of functions should be subject to similar cost recovery mechanisms. We achieve that result by moving away from the regime preserved by section 251(g) and bringing that traffic within the section 251(b)(5) framework.

222. We disagree with commenters who argue that section 251(b)(5) only can be applied to traffic exchanged

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[571] *WorldCom*, 288 F.3d at 430.

[572] Verizon notes that although the Commission in the *ISP Remand Order* deleted the word "local" from its regulations governing reciprocal compensation, the regulations continued to exclude access services from the scope of section 251(b)(5). *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24-32; 47 C.F.R. § 51.701(b)(1). At that time, it made sense to retain the access exemption because the Commission had not issued rules superseding the access regime preserved by section 251(g). We supersede the grandfathered access regime in this order, at least in part.

[573] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 12.

between LECs, and not traffic exchanged between a LEC and another carrier.[574] The Commission rejected that argument in the *Local Competition Order*, finding that section 251(b)(5) applies to traffic exchanged by a LEC and any other telecommunications carrier, and adopted rules implementing that finding.[575] In a specific application of that principle, the Commission concluded that "CMRS providers will not be classified as LECs,"[576]

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[574] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments ("The best interpretation of § 251(b)(5)—read in light of the text, structure, and history of the 1996 Act—is that the reciprocal compensation obligation applies only to intraexchange (or 'local') voice calls that originate on the network of one LEC (or wireless provider) and terminate on the network of another LEC (or wireless provider) operating in the same exchange (or, in the case of wireless providers, the same MTA."); Verizon and BellSouth, Internet-Bound Traffic is Not Compensable Under Sections 251(b)(5) and 252(d)(2) at 26 (Verizon/BellSouth ISP White Paper) ("By its nature, 'reciprocal compensation' must . . . apply to 'telecommunications' exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs."), *attached to* Letter from Ann D. Berkowitz, Associate Director, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 (filed May 17, 2004).

[575] *See Local Competition First Report and Order*, 11 FCC Rcd at 16013-16, paras. 1034-41. *See also* 47 C.F.R. 51.703(a) ("Each LEC shall establish reciprocal compensation arrangements for transport and termination of telecommunications traffic with any requesting telecommunications carrier."); *ISP Remand Order*, 16 FCC Rcd at 9193-94, para. 89 n.177 ("Section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier . . . .").

[576] *Local Competition First Report and Order*, 11 FCC Rcd at 15996, para. 1005. In this regard, we note that, absent a determination that CMRS providers are LECs, IXC-CMRS traffic would not be encompassed by section 251(b)(5), since neither are LECs. Nevertheless, it is our intention that, at the end of the transition, CMRS providers be entitled to reciprocal compensation for all the traffic they terminate. As the Commission has observed, "[t]here are three

but nevertheless found that "LECs are obligated, pursuant to section 251(b)(5) (and the corresponding pricing standards of section 252(d)(2)), to enter into reciprocal compensation agreements with all CMRS providers."[577] No one challenged that finding on appeal, and it has been settled law for the past 12 years. We see no reason to revisit that conclusion now. Although section 251(b)(5) indisputably imposes the duty to establish reciprocal compensation arrangements on LECs alone, Congress did not limit the class of potential beneficiaries of that obligation to LECs.[578]

223. We also disagree with commenters who argue that section 252(d)(2)(A)(i) limits the scope of section 251(b)(5).[579] Section 252(d)(2)(A)(i) provides that a state commission "shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless "such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's

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ways in which a carrier seeking to impose charges on another carrier can establish a duty to pay such charges: pursuant to (1) Commission rule; (2) tariff; or (3) contract." *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges, Declaratory Ruling*, 17 FCC Rcd 13192, 13196, para. 8 (2002).

[577] *Local Competition First Report and Order*, 11 FCC Rcd at 15997, para. 1008.

[578] If Congress had intended to limit the class of potential beneficiaries of LECs' duty to establish reciprocal obligation arrangements, it would have said so explicitly. *See* 47 U.S.C. § 251(b)(3) (describing the "duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service").

[579] *See, e.g.*, Verizon/BellSouth ISP White Paper at 41-43; New York State PSC *ICC FNPRM* Comments at 8-9; TDS *ICC FNPRM* Comments at 19 n.27; Qwest *ICC FNPRM* Comments at 39; NASUCA *ICC FNPRM* Reply at 17-18.

network facilities of calls that originate on the network facilities of the other carrier."[580] Verizon and others argue that this provision necessarily excludes interexchange traffic from the scope of section 251(b)(5) because at the time the 1996 Act was passed, calls neither originated nor terminated on an IXC's network.[581] We reject this reasoning because it erroneously assumes that Congress intended the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5). We do not believe that Congress intended the tail to wag the dog.

224. Section 251(b)(5) defines the scope of traffic that is subject to reciprocal compensation. Section 252(d)(2)(A)(i), in turn, deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies. Section 252(d)(2)(A)(i) provides that, at a minimum, a reciprocal compensation arrangement must provide for the recovery by each carrier of costs associated with the transport and termination on each carrier's network of calls that originate on the network of the other carrier.[582] Section 252(d)(2)(A)(i) does not address what happens when carriers exchange traffic that originates or terminates on a third carrier's network. This does not mean, as Verizon suggests, that section 251(b)(5) must be read as limited to traffic involving only two carriers. Rather, it means that there is a gap in the pricing rules in section 252(d)(2), and the

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[580] 47 U.S.C. § 252(d)(2)(A)(i).

[581] *See, e.g.*, Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7-8; New York State PSC *ICC FNPRM* Comments at 7-10; Verizon/BellSouth Supp. ISP White Paper at 16-20; NARUC *ICC FNPRM* Comments at 7 n.13.

[582] 47 U.S.C. § 252(d)(2)(A)(i).

Commission has authority under section 201(b) to adopt rules to fill that gap.

225. We reject Verizon's argument that a telecommunications carrier that delivers traffic to an ISP is not eligible for reciprocal compensation because the carrier does not "terminate" telecommunications traffic at the ISP.[583] In the *Local Competition Order*, the Commission defined "termination" as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises."[584] As the D.C. Circuit suggested in the *Bell Atlantic* decision, "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"[585] We agree.[586] Consequently, ISP-bound traffic is subject to our new intercarrier compensation framework.[587]

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[583] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 33-34; Verizon/BellSouth ISP White Paper at 31-32.

[584] *Local Competition First Report and Order*, 11 FCC Rcd at 16015, para. 1040. *See also* 47 C.F.R. § 51.701(d).

[585] 206 F.3d at 6.

[586] Because ISP-bound traffic did not fall within the section 251(g) carve out from section 251(b)(5) as "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound Traffic," *WorldCom*, 288 F.3d at 433, ISP-bound traffic is, and always has been, subject to section 251(b)(5), although clearly interstate in nature and subject to our section 201 authority.

[587] We reject Verizon's argument against the application of section 251(b)(5) to ISP-bound traffic because this traffic is one-way traffic and as such is not reciprocal. *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 41-43. As Level 3 points out, these arguments have been rejected by the Commission and the U.S. Court of Appeals for the Ninth Circuit. *See* Level 3 Aug. 18, 2008 *Ex Parte* Letter at 18; *Pacific Bell v. Cook Telecom, Inc.*, 197 F.3d 1236, 1242-44 (9th Cir. 1999) (reciprocal

226. We reject opponents' other arguments that the context and history of the 1996 Act compel a finding that section 251(b)(5) could not be applied to access traffic. Verizon argues, for example, that section 251(g) demonstrates that Congress did not intend to displace the existing access pricing regime.[588] This argument ignores that Congress preserved the access regime only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[589] As noted above, we find that section 251(g) actually supports a finding that section 251(b)(5) is broad enough to cover access traffic. Verizon also argues that the reference to reciprocal compensation in the competitive checklist in section 271,[590] which was designed to ensure that local markets are open to competition, somehow shows that Congress intended to limit the scope of section 251(b)(5) to local traffic.[591] We do not see how this argument sheds any light on the scope of section 251(b)(5). Congress no doubt included the reference to reciprocal compensation

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compensation applies to paging traffic); *TSR Wireless, LLC v. U.S. West Commc'ns, Inc.*, 15 FCC Rcd 11166, 11178, para. 21 (2000) (the Commission's reciprocal compensation rules draw "no distinction between one-way and two-way carriers"). Because our conclusion in this order concerning the scope of section 251(b)(5) is no longer tied to whether this traffic is local or long distance, we need not address arguments made by the parties as to whether ISP-bound traffic constitutes "telephone exchange service" under the Act. *See, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 1 (filed Sept. 24, 2004). We note, however, that we retain our interim ISP-bound traffic rules. *See supra* paras. 198-205.

[588] *See* Verizon *ICC FNPRM* Comments at 41.

[589] 47 U.S.C. § 251(g).

[590] *See* 47 U.S.C. § 271(c)(2)(B)(xiii).

[591] *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 9.

in section 271 because section 251(b)(5) applies to local traffic, a point that no one disputes. That does not suggest, however, that section 251(b)(5) applies *only* to local traffic.

227. We need not respond to every other variation of the argument that the history and structure of the Act somehow demonstrate that section 251(b)(5) does not apply to access traffic. At best, these arguments show that one plausible interpretation of the statute is that section 251(b)(5) applies only to local traffic, a view that the Commission embraced in the *Local Competition First Report and Order*. These arguments do not persuade us, however, that this is the only plausible reading of the statute. Moreover, many of the same arguments based on the history and context of the adoption of section 251 to limit its scope to local traffic were rejected by the D.C. Circuit in the context of section 251(c).[592] We find that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2).

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[592] *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) (*USTA II*) ("Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not 'telecommunications services' has no support."). In *USTA II*, the D.C. Circuit was addressing whether the term "telecommunications services" was limited to local telecommunications services under section 251(c), while here we consider the analogous question of whether "telecommunications" is limited to local telecommunications under section 251(b).

228. The approach we adopt here provides a sound basis for comprehensive reform, and we thus decline to adopt alternative proposals. On one hand, we note that some commenters advocate that the Commission adopt an intercarrier compensation rate or cap of $0.0007 per minute of use for all traffic.[593] To implement this reform proposal, parties have suggested that it would likely be necessary for the Commission to preempt state regulation of intrastate access charges.[594] We believe that such a significant step is not currently warranted, and elect instead to allow states to continue setting rates for intrastate traffic, as well as permitting them to set rates for traffic subject to federal jurisdiction, pursuant to our methodology. We fully expect the new pricing methodol-

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[593] *See, e.g.*, Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. A at 1 (filed Oct. 6, 2008); Letter from Teresa D. Bauer and Richard R. Cameron, Counsel for Global Crossing North America, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 18, 2008); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Kevin Martin et al., Commissioners, FCC, CC Docket. 01-92 at 4 (filed Sept. 12, 2008) (Verizon Sept. 12, 2008 *Ex Parte* Letter). *But see, e.g.*, Letter from Richard A. Askoff, Executive Director—Regulatory, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Oct. 7, 2008) ("Prescription of a nationwide uniform default rate of $0.0007 is unnecessary to solve the rate arbitrage problems identified by Verizon. It would also represent bad policy."); Letter from Lawrence Zawalick, Senior Vice President, Rural Telephone Finance Cooperative, to Kevin Martin et al., Commissioners, FCC, CC Docket 01-92 at 1 (filed Sept. 30, 2008) ("The Rural Telephone Finance Cooperative (RTFC) strongly opposes [the $0.0007] proposal.").

[594] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 14-25 (filed Sept. 19, 2008) (Verizon Sept. 19, 2008 *Ex Parte* Letter).

ogy to achieve the goals of our continuing intercarrier compensation reform. On the other hand, some parties contend that the Commission should leave matters of intrastate intercarrier compensation reform entirely to the states.[595] These proposals evidence a pre-1996 Act worldview, however. Given the tools that the 1996 Act put at our disposal, we find it possible to move forward with truly comprehensive intercarrier compensation reform under an approach which still provides for a state role.

229. We note that, in the *Local Competition First Report and Order*, the Commission observed that section 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such charges were prohibited under that provision of the Act.[596] Because we elect to have the states set rates under section 251(b)(5), pursuant to our methodology, we find that retention of originating charges would be inconsistent with that statutory scheme and our new regulatory approach. Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated at the conclusion of the transition to the new regime. We recognize, however, that changes to originating access charge rates may raise issues distinct

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[595] In some cases, parties propose that the Commission make available universal service support as an "enticement" for states to reform intrastate rates, but ultimately the decisions would be left to the individual states. *See* Letter from Tom Karalis, Counsel for Rural Alliance, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Sept. 26, 2008).

[596] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042. *See also* 47 C.F.R. § 51.703(b) (stating that a "LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network").

from terminating charges. Moreover, several parties urge the Commission to delay any changes to originating charges.[597] For these reasons, we ask parties to comment on the appropriate transition for eliminating originating access charges in the accompanying Further Notice.[598] Although we ask parties to comment on the appropriate transition for eliminating originating access charges, we clarify that, under the transitional mechanism we adopt today, carriers are not permitted to increase any of their current rates, including their originating access rates.[599]

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[597] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter at 5 (asking the Commission to defer reform of originating access); Letter from Grace E. Kohl, Policy Counsel, Cox, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, CC Docket Nos. 96-45, 01-92, 99-68, 96-262 at 2 (filed Oct. 6, 2008) (supporting proposals to delay reform of originating access) (Cox Oct. 6, 2008 *Ex Parte* Letter); Letter from Brian Benison, Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 05-337, 07-135, Attach. at 3 (filed Oct. 7, 2008) (describing model with "No Change to Current Structure and Rates" for originating access); Letter from Kathleen O'Brien Ham, Federal Regulatory Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 5 (filed Oct. 3, 2008); *cf.* Letter from Mary C. Albert, Assistant General Counsel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, Attach. at 1 (filed Oct. 2, 2008) (urging the Commission to delay any changes to intercarrier compensation). *But see* Letter from Anna M. Gomez, Vice President, Government Affairs, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 7 (filed Oct. 1, 2008) (urging the Commission to reform originating access immediately) (Sprint Oct. 1, 2008 *Ex Parte* Letter).

[598] *See infra* para 346.

[599] This prohibition on increasing access rates also applies to the Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, and the per-minute Resid-

Thus, both interstate and intrastate originating switched access rates will remain capped at current levels until further action by the Commission addressing the appropriate transition for this traffic. This approach is consistent with our transition of terminating rates[600] and with our goal of eliminating originating access charges at the conclusion of the transition to the new regime.

b. Legal Authority for the Transition

230. Although we comprehensively reform intercarrier compensation, we do not flash cut to our new regime, but provide for a measured transition.[601] The goal of this transition is to avoid overly rapid rate changes for consumers while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.[602] For many of the same reasons that we have authority to adopt comprehensive reform, we find that the Commission has clear

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ual Interconnection Charge in section 69.155 of the Commission's rules. 47 C.F.R. §§ 69.153, 69.154, 69.155.

[600] *See supra* paras. 194-95 (prohibiting carriers from increasing their current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates).

[601] *See supra* section V.B.2.

[602] This approach is consistent with Commission precedent set forth in Part V.A, which started reforming intercarrier compensation in the 1980s. There the Commission found that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end-user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act." *1983 Access Charge Order*, 93 FCC 2d at 243, para. 4. As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

authority to establish such a transitional structure to serve as a glide path to the new methodology we have developed in this order.

231. We find it reasonable to adopt a transition plan under these circumstances. As the D.C. Circuit has recognized, avoiding "market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule,"[603] and here temporary rules setting forth a glide path are needed to mitigate potentially adverse rate or revenue effects that may be caused by our comprehensive intercarrier compensation reform, including the elimination of implicit universal service subsidies in those rates. Therefore, the Commission's exercise of its authority to create a transition plan is especially appropriate here, where the Commission is acting to reconcile the Act's "implicit tension between . . . moving toward cost-based rates and protecting universal service."[604] Not surprisingly, most commenters have affirmatively recognized the need for a transitional regime.[605] Indeed, every major plan submitted to us in this

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[603] *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002).

[604] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

[605] *See, e.g.*, BellSouth *ICC FNPRM* Comments at 17 ("In order to avoid the market disruption and dislocation that would be associated with instantaneous implementation of a unified plan, BellSouth proposes a two-phase transition plan."); CCG *ICC FNPRM* Comments at 2 ("Any plan that reduces access rates should be phased-in over as long a period as possible, at least for rural carriers, so these companies have time to prepare for and adjust to the economic impact."); Cincinnati Bell *ICC FNPRM* Comments at 12 ("The Commission must allow carriers the opportunity to earn this lost access revenue in the transition to a new compensation regime in order to make any regime change revenue neutral to the affected carriers."); CCAP *ICC FNPRM* Comments at 23 ("The CCAP believes that any reform

proceeding, whether the Missoula plan,[606] the ICF plan,[607] Verizon's plan,[608] AT&T's plan,[609] or the plan from CBICC,[610] ARIC,[611] NARUC,[612] or NASUCA,[613] has called for the Commission to establish an orderly transition period. We take heed of these commenters and of our statutory responsibilities to ensure a smooth transition to the new regime by setting forth a multi-stage transition plan as part of our comprehensive reform of intercarrier compensation.

232. Moreover, we have several independent sources of legal authority to adopt the transition plan established in this order. For one, section 251 explicitly contemplates our authority to adopt a transitional scheme with regard to access charges. We agree with the United States Court of Appeals for the District of Columbia Circuit that section 251(g) created a "transitional enforce-

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of the existing intercarrier compensation regimes should take place over a three-to five-year period . . . .").

[606] Missoula Plan, Executive Summary at 3 ("Recognizing the vast differences among carriers, the Plan creates three different transition schedules for intercarrier compensation rates.").

[607] Letter from Gary M. Epstein and Richard R. Cameron, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 2 at 3 (filed Aug. 16, 2004).

[608] Verizon Sept. 12, 2008 *Ex Parte* Letter at 9-10.

[609] Letter from Henry Hultquist, Federal Regulatory Vice-President, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach 1 at 4 (filed July 17, 2008).

[610] Letter from Richard M. Rindler, Counsel for CBICC, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 2.

[611] ARIC *ICC FNPRM* Comments, Attach. 1 at 33.

[612] NARUC *ICC FNPRM* Comments, Attach. C at 6.

[613] Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 1 (filed Dec. 14, 2004).

ment mechanism"[614] preserving the access charge regimes that predated the 1996 Act "until . . . explicitly superseded by regulations *prescribed by the Commission.*"[615] Thus, section 251(g), by its terms, anticipates that the Commission may take action to end the regimes grandfathered by section 251(g), and inherent within the power to supersede the grandfathered access regime is the lesser power to prescribe regulations that determine *how* to transition to a cost-based pricing mechanism—a power that we have twice employed in the past to reduce access charges without explicitly superseding that regime.[616]

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[614] *WorldCom*, 288 F.3d at 433.

[615] 47 U.S.C. § 251(g) (emphasis added). At the least, section 251(g) preserved the interstate access regime the Commission had prescribed for all carriers (*see id.* (preserving "obligations (including receipt of compensation) . . . under any . . . regulation, order, or policy of the Commission . . . .")) and the intrastate access regime the Bell Operating Companies had agreed to in the Modified Final Judgment. *See United States v. AT&T*, 552 F. Supp. at 169. Recognizing, however, that it would be "'incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms,'" the Commission has consistently interpreted section 251(g) to preserve the intrastate access regime predating the Act for all carriers. *ISP Remand Order*, 16 FCC Rcd at 9168 n.66 (quoting *Local Competition First Report and Order*, 11 FCC Rcd at 15869, para. 732); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) ("[I]t is clear from the Act that Congress did not intend all access charges to move to cost based pricing, at least not immediately. The Act plainly preserves certain rate regimes already in place.").

[616] *See MAG Order*, 16 FCC Rcd 19613 (reducing interstate access charges for rate-of-return carriers); *CALLS Order*, 15 FCC Rcd 12962 (reducing interstate access charges for price cap carriers), *aff'd in relevant part by Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d at 324 (reasoning that because the Commission had not yet

233. In addition, as the Supreme Court has further held, the Commission has authority to prescribe the requisite pricing methodology that the States will apply in setting rates under section 252(d)(2).[617] Consistent with our authority, the Commission here is providing for a transitional regime in the public interest to smooth the transition to the new pricing standard adopted by this order. The goal of this transition is to allow gradual changes to consumer rates while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.

234. Significantly, as discussed in greater detail above, although we elect to rely on the sections 251(b)(5) and 252(d)(2) framework for reform, that does not affect the Commission's jurisdiction over traffic or services otherwise subject to federal authority.[618] With respect to interstate services, the Act has long provided us with the authority to establish just and reasonable "charges, practices, classifications, and regulations."[619] The Commission also has authority over the rates of CMRS providers pursuant to section 332 of the Act.[620] The Commission

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superseded the pre-Act interstate access regime, it retained authority under section 201(b) to set just and reasonable rates for interstate access); *see also WorldCom*, 288 F.3d at 433 ("We will assume without deciding that under § 251(g) the Commission might modify LECs' pre-Act 'restrictions' or 'obligations,' pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption . . . .").

[617] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 384; *see also id.* at 378 ("The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252, added by the Telecommunications Act of 1996.")

[618] *See supra* section V.B.3.

[619] 47 U.S.C. § 201(b).

[620] 47 U.S.C. § 332.

thus retains full authority to adopt transition plans for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework. Because we reaffirm our findings concerning the interstate nature of ISP-bound traffic, it follows that such traffic falls under the Commission's section 201 authority preserved by the Act.[621] This conclusion is rein-

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[621] We have consistently found that ISP-bound traffic is jurisdictionally interstate. ISP-bound traffic melds a traditional circuit-switched local telephone call over the PSTN to packet switched IP-based Internet communication to Web sites. *Declaratory Ruling*, 14 FCC Rcd at 3702, para. 18; *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. This conclusion has not been questioned by the D.C. Circuit. *See WorldCom*, 288 F.3d at 431; *Bell Atlantic v. FCC*, 206 F.3d at 5 ("There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate"). In other contexts, the Commission has likewise found that services that offer access to the Internet are jurisdictionally interstate services. In 1998, for example, the Commission found that ADSL service is jurisdictionally interstate. *See GTE Tel. Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22481, para. 28 (1998) ("finding that GTE's ADSL service is subject to federal jurisdiction" and is "an interstate service"). More recently, the Commission has confirmed this ruling for a variety of broadband Internet access services. *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4832, para. 59 (2002) (finding that, "on an end-to-end analysis," "cable modem service is an interstate information service"); *Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14914, para. 110, *aff'd by Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.* (*Brand X*), 545 U.S. 967 (2005); *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT 07-53, Declaratory Ruling, 22 FCC Rcd 5901, 5911, para. 28 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, WC 06-10, Memorandum Opinion and Order, 21 FCC

forced by section 251(i) of the Act. As the Commission explained in the *ISP Remand Order*, section 251(i) "expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[622] It concluded that section 251(i), together with section 201, equips the Commission with the tools necessary to keep pace with regulatory developments and new technologies.[623] When read together, these statutory sections preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic. Consequently, in the *ISP Remand Order*, the Commission properly exercised its authority under section 201(b) to issue interim pricing rules governing the payment of compensation between carriers for ISP-bound traffic.[624]

Red 13281, 13288, para. 11 (2006). In the *Vonage Order*, the Commission likewise found that VoIP services are jurisdictionally interstate, employing the same end-to-end analysis reflected in those other orders. *Vonage Order*, 19 FCC Rcd at 22413-14, paras. 17-18.

[622] *ISP Remand Order*, 16 FCC Rcd at 9174, para. 50.

[623] *See ISP Remand Order*, at 9175, para. 51.

[624] We thus respond to the D.C. Circuit's remand order in *WorldCom*, 288 F.3d at 434, and the court's writ of mandamus in *Core Communications*, 531 F.3d at 861-62, which directed the Commission to explain its legal authority to issue the interim pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*. Specifically, we find, for the reasons set forth above and in Part V.B.3, that the Commission had the authority to adopt the interim pricing regime pursuant to our broad authority under section 201(b) to issue rules governing interstate traffic.

235. This result is consistent with the D.C. Circuit's opinion in *Bell Atlantic*, which concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under section 251(b)(5).[625] It is also consistent with the court's *WorldCom* decision, in which the court rejected the Commission's view that section 251(g) excluded ISP-bound traffic from the scope of section 251(b)(5), but made no other findings.[626] Finally, this result does not run afoul of the Eighth Circuit's decision on remand from the Supreme Court in the *Iowa Utilities Board* litigation, which held that "the FCC does not have the authority to set the actual prices for the state commissions to use" under section 251(b)(5).[627] At the time of that decision, under the *Local Competition First Report and Order*, section 251(b)(5) applied only to local traffic. Thus, the Eighth Circuit merely held that the Commission could not set reciprocal compensation rates for local traffic. The court did not address the Commission's authority to set reciprocal compensation rates for interstate traffic.[628] In sum, the Commission plainly has authority to establish pricing rules for interstate traffic, including ISP-bound traffic, under section 201(b), and that authority was preserved by section 251(i).

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[625] *See Bell Atlantic*, 206 F.3d at 5.

[626] *See WorldCom*, 288 F.3d at 434.

[627] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000) (*Iowa Utils. II*), *rev'd in part sub nom. Verizon v. FCC*, 535 U.S. 467.

[628] Indeed, as discussed above, the court expressly confirmed the Commission's independent authority to set rates for CMRS traffic pursuant to section 332 and declined to vacate the Commission's pricing rules as they applied in the context of CMRS service. *See supra* para. 214; *Iowa Utils. I*, 120 F.3d at 800 n.21.

4. Additional Costs Standard

236. We now turn to reconsideration of our "additional costs" standard for implementing section 252(d)(2). Before describing our new standard, we briefly review the relevant statutory language and the Commission's implementation of the "additional costs" standard in the *Local Competition First Report and Order*. We then explain the importance of incremental cost in regulated pricing. Next we examine the incremental cost of call termination on modern networks. Finally we describe in detail the "additional costs" standard we adopt in this order.

a. Background

237. Section 252(d)(2)(A) sets forth the standard that state commissions, in arbitrating interconnection disputes, should apply in setting the "charges for transport and termination of traffic." That section states that "[f]or the purposes of compliance . . . with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."[629] Section 252(d)(2)(B) provides that the preceding standard "shall not be construed (i) to preclude arrangements that afford the mutual recovery of costs through offsetting of reciprocal obligations, including arrangements that waive mutual recover[y] (such as bill

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[629] 47 U.S.C. § 252(d)(2)(A).

and keep arrangements); or (ii) to authorize the Commission or any State commission to engage in any rate regulation proceedings to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls."[630]

238. In the *Local Competition First Report and Order*, the Commission adopted implementing rules interpreting section 252's pricing standards for interconnection and UNEs (section 252(d)(1)), and for reciprocal compensation (section 252(d)(2)). In setting the pricing methodology for interconnection and UNEs, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, known as TELRIC.[631] The TELRIC methodology assumes that the relevant increment of output is all current and reasonably projected future demand, (i.e., it is designed to calculate the total cost of building a new, efficient network).[632] The Commission found that TELRIC rates should also include a reasonable allocation of forward-looking common costs, including overhead costs. Thus, TELRIC calculates the long-run average incremental cost of a network element. In setting the pricing methodology for reciprocal compensation, the Commission concluded that the statutory pricing standards for interconnection and UNEs (section 252(d)(1)), and for transport and termination of traffic (section 252(d)(2)), were "sufficiently similar" to permit the use of the same TEL-

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[630] 47 U.S.C. § 252(d)(2)(B).

[631] *Local Competition First Report and Order*, 11 FCC Rcd at 15515, 15844-96, paras. 29, 672-732.

[632] *Local Competition First Report and Order*, 11 FCC Rcd at 15850-57, paras. 690-703, *see also* 47 C.F.R. § 51.505.

RIC methodology for establishing rates under both statutory provisions.[633]

239. Market developments since the adoption of the *Local Competition First Report and Order* demonstrate that application of the TELRIC methodology to reciprocal compensation has led to "excessively high reciprocal compensation rates."[634] More specifically, following the Commission's order, certain carriers began designing business plans to take advantage of above-cost reciprocal compensation payments by becoming a net recipient of

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[633] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054. In applying the TELRIC methodology to reciprocal compensation, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching." For purposes of setting rates, the Commission concluded that "only that portion of the forward-looking, economic cost of end office switching that is recovered on a usage-sensitive basis constitutes an 'additional cost' to be recovered through termination charges." *Id.* at 16024-25, para. 1057. The Commission excluded non-traffic sensitive costs, such as the costs of local loops and line ports. *Id.* Further, the Commission concluded that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of forward-looking common costs because, the Commission reasoned, a rate equal to incremental costs may not compensate carriers fully when common costs are present. *Id.* at 16025, para. 1058. For transport, the Commission required the calling party's LEC to compensate the called party's LEC for the "additional costs" associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office and for the additional costs of terminating the call to the called party. *Id.* at 16008-58, paras. 1027-118; see also 47 C.F.R. §§ 51.701(c), (d).

[634] *ISP* Remand Order, 16 FCC Rcd at 9185, para. 75); see also Letter from Norina Moy, Director, Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36 (filed Sept. 26, 2008) (Sprint Nextel Sept. 26, 2008 Ex Parte Letter).

local traffic. The most prevalent example of regulatory arbitrage for reciprocal compensation is ISP-bound traffic where the Commission found evidence that "CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients" of reciprocal compensation payments.[635] As a result, the Commission has found that reciprocal compensation rates "do not simply compensate the terminating network, but also appear to generate profits for each minute that is terminated, thus creating a potential windfall."[636] In short, the evidence indicates that application of the TELRIC methodology to reciprocal compensation has not led to rates that accurately reflect a carrier's "additional costs" as the Commission initially envisioned and Congress intended. Rather, the Commission's existing pricing standard has led to rates that not only vary significantly among states,[637] but are

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[635] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11.

[636] *See, e.g., Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11; *see also Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4698 n.67 ("[R]eciprocal compensation rates often substantially exceed the per-minute incremental cost of terminating a call and therefore create a potential windfall for carriers that serve customers that primarily or exclusively receive traffic."); *ISP Remand Order*, 16 FCC Rcd at 9192, para. 87 ("[T]here may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination."); BellSouth *ICC* NPRM Comments at 9 ("[R]eciprocal compensation payments enabled carriers to offer services to their customers at rates that bore little relationship to actual costs and provided the recipients of reciprocal compensation an advantage over their competitors."); Verizon *2000 Remand of ISP Declaratory Ruling Public Notice* Comments at 11-12 (noting that competitive LECs with ISP customers reap a "windfall profit" because of high reciprocal compensation rates).

[637] *See, e.g.*, Eastern Rural Telecom Ass'n *ICC FNPRM* Comments at 2-3 ("Depending on the assumptions used to develop a company's

generally too high, and which ultimately create regulatory arbitrage opportunities. Based on this evidence, and as detailed further below, we therefore conclude that we need to revise the current reciprocal compensation pricing methodology to align our standard more closely with the statutory text and with economic theory to eliminate, as far as possible, opportunities for regulatory arbitrage.

b. The Importance of Incremental Cost In Regulated Pricing

240. To provide a framework for our reconsideration of the proper "additional costs" methodology, we begin with a brief overview of long-standing principles for public utility pricing. As explained below, we believe the traditional economic definition of incremental cost, as applied to multiproduct firms, is most appropriate for setting intercarrier compensation rates. The Commission's existing TELRIC standard governing reciprocal compensation deviates from this more efficient version of incremental cost, and is likely to lead to rates that significantly exceed efficient levels. We also consider evidence in the record concerning costs of switches and fiber.

241. In economic theory generally and in its application to regulation, the relationship of price and marginal cost is of fundamental importance. Marginal cost can be simply defined as the rate of change in total cost when output changes by an infinitesimal unit. In economics, the term incremental cost refers to a discrete change in total cost when output changes by any non-infinitesimal amount, which might range from a single unit to a large increment representing a firm's entire output.[638] The

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TELRIC study, the results can vary significantly and be open to challenge.").

[638] If $C(q)$ represents the cost of producing an output q and Δq represents an increment of output, then incremental cost is equal to

terms additional costs and avoidable costs are commonly used to refer to incremental costs resulting from an increase or a decrease in output respectively.[639]

242. In a competitive market, it is assumed that both consumers and producers independently will choose outputs to purchase or to supply on the basis of a market price. In standard economic analysis, this price is determined by the intersection of a downward sloping demand function, which represents consumer valuations for additional units of consumption, and an upward sloping supply function, which represents the marginal cost of supplying an additional unit. The competitive price is efficient in the following sense. At any other price, consumer demands would no longer be equal to producer supply, and market transactions would be limited to the smaller of the two terms.[640] At this level of output, consumers would value an additional unit of output more than the cost of producing it as determined by the marginal cost function. Hence both consumers and producers could be made better off by increasing output by a

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$C(q+\Delta q) - C(q)$. If incremental cost is used as a guide to pricing, then price should be set equal to the average incremental cost $\frac{C(q+\Delta q)-C(q)}{\Delta q}$ If there are no fixed costs and initial output $q = 0$, then incremental cost pricing is equivalent to average cost pricing. If Δq is small, then incremental cost pricing approximates marginal cost pricing. *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15844, para. 675.

[639] 1 KAHN, THE ECONOMICS OF REGULATION at 65-66. *See also* PRINCIPLES OF PUBLIC UTILITY RATES at 393.

[640] If price is greater than the competitive level, consumer demand is less than supply, and demand would determine market volume. If price is less than the competitive level, then producers voluntarily would supply no more than the amount at which marginal cost is equal to price.

small amount.[641] When price is equal to the competitive price, no alternative price can be found such that both consumer and producers are better off.

243. *Forward-looking versus Historical Cost*: When prices are determined in a regulated market, similar reasoning applies. In this context, there is a large amount of literature on practical rules and procedures that must be considered to achieve an outcome that is as close as possible to a fully efficient one.[642] The cost of any economic resource is equal to its value in the best alternative use. The cost which a regulated firm incurs in producing a particular output is therefore equal to the value of the economic resources that are used to produce it, and which are therefore no longer available for the production of alternative goods and services. It follows that from the standpoint of economic efficiency, the only costs that are relevant in pricing decisions of a regulated firm are current or future costs, and that historical costs can be ignored.[643] We acknowledge that economists and industry experts have often debated the relative merits of

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[641] Where the market price exceeds marginal cost, there will be an associated deadweight loss in social welfare. The deadweight loss represents the loss in consumer plus producer surplus caused by a deviation from the competitive equilibrium. *See, e.g.*, DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 84 (1990); KENNETH E. TRAIN, OPTIMAL REGULATION 185 (1992) (OPTIMAL REGULATION).

[642] *See, e.g.*, Ronald. H. Coase, *The Theory of Public Utility Pricing and Its Applications*, 1 BELL J. ECON. 113, 113-128 (1970) (*Theory of Public Utility Pricing*); 1 KAHN, THE ECONOMICS OF REGULATION at 63-86.

[643] *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 122; Alexander C. Larson, *An Economic Guide to Competitive Standards in Telecommunications Regulation*, 1 COMMLAW CONSPECTUS 31, 47 n.100 (1993) (quoting *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 121-22).

forward-looking (or reproduction) cost versus historical (or original) capital cost in administering rate-of-return regulation,[644] and that regulators, including state regulators and this Commission, have continued to use historical cost in rate setting for smaller, primarily rural telephone companies. Nevertheless, since the adoption of the *Local Competition First Report and Order*, the Commission has consistently concluded that it believes that forward-looking costs are the most appropriate measure of cost.[645] In this order, we reaffirm our conclusion that forward-looking costs should form the basis for regulation in a uniform intercarrier compensation regime.

244. *Short-Run versus Long-Run Incremental Cost*: Economists have also debated whether it is appropriate to use short-run or long-run incremental cost as a guide for regulatory pricing.[646] Short-run incremental cost refers to the cost of an increment of demand when some inputs to production are in fixed supply. Long-run incremental cost refers to the cost of an increment when all inputs are variable. In order to set prices so as to maximize economic efficiency at any particular point in time, it is clear that short-run incremental cost is the appropriate concept.[647] For example, if an airline carrier has empty seats for a particular scheduled flight, then it

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[644] *See, e.g.*, 1 KAHN, THE ECONOMICS OF REGULATION at 109-16.

[645] *Local Competition First Report and Order*, 11 FCC Rcd at 15813, 15846, paras. 620, 679.

[646] *See* 1 KAHN, THE ECONOMICS OF REGULATION at 70-75, 83-103; *see also* PHILLIPS, THE ECONOMICS OF REGULATION at 390-91 (rev. ed. 1969); PRINCIPLES OF PUBLIC UTILITY RATES at 417-25.

[647] 1 KAHN, THE ECONOMICS OF REGULATION at 71; DANIEL F. SPULBER, REGULATION AND MARKETS 234 (1989) (REGULATION AND MARKETS).

would make sense to sell capacity for those seats at any price that would recover the small additional costs of fuel and amenities for an additional passenger. Pricing based on short-run incremental cost, however, necessarily implies that prices can be adjusted freely and perhaps continuously during the day.[648] Moreover, in a regulatory context, such flexibility is likely infeasible.

245. Short- or intermediate-run costs might also be advocated on practical grounds, since some productive inputs (e.g., poles and conduits) can have extremely long lives. Nevertheless, regulators have traditionally relied on long-run incremental costs rather than short-run incremental costs in setting regulated prices. First, setting prices on the basis of short-run incremental cost may mean that a carrier would not recover its average total cost of investment over the life of the asset.[649] Second, to the extent that forward-looking costs are used, long-run incremental costs are more naturally and easily accommodated, since a forward looking cost study can legitimately assume that all inputs are variable. In the *Local Competition First Report and Order*, the Commission, in adopting its TELRIC methodology, explained that "[t]his 'long run' approach ensures that rates recover not only the operating costs that vary in the short run, but also the fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element."[650] We reaffirm here the Commission's decision in the *Local Competition First Report and*

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[648] 1 KAHN, THE ECONOMICS OF REGULATION at 84.

[649] 1 KAHN, THE ECONOMICS OF REGULATION at 88.

[650] *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 692.

Order that long-run incremental cost rather than short-run incremental cost is the appropriate cost concept.[621]

246. *Peak Load Pricing*: Closely related to the question of short-run versus long-run costing is the issue of peak load pricing. When demand varies systematically by time of day, day of the week, or over longer periods, there may be periods of time when there is significant excess capacity, since productive inputs clearly cannot vary with such frequency. In such cases, economic efficiency might require that prices should vary by time or day or over longer periods even in the long run.[622] For example, many wireless telephone carriers offer free minutes of usage during weekends or evenings. Although these arguments are indisputable, it has proven difficult in practice to incorporate peak load pricing principles into regulated rate proceedings.[623] Accordingly, we conclude, as the Commission did in the *Local Competition First Report and Order*, that we should not require peak-load pricing as part of an intercarrier compensation regime, although we affirm that carriers should be free to voluntarily negotiate agreements including peak pricing principles.

247. *Common Costs*: Telecommunications carriers are multiproduct firms which provide a large array of services to different groups of consumers. Within the category of traditional telephony, these services include call origination, call termination, local transport, and either access to long distance transport or long distance

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[621] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054.

[622] 1 KAHN, THE ECONOMICS OF REGULATION at 89.

[623] *See Local Competition First Report and Order* at 15878, paras. 755-57. *See also* 1 KAHN, THE ECONOMICS OF REGULATION at 91-93.

service through an affiliated carrier. As networks evolve, the number of services that a telecommunications network can provide is rapidly expanding to include Internet access and other data services and, in some cases, video distribution. Many of these services share common facilities.[654] For example, a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services. The incremental cost of voice service, assuming that DSL is already provided, therefore does not include any of the long run incremental cost of the loop itself. Similarly, the incremental cost of DSL, assuming voice is already provided, includes only that portion of the loop cost that may be required to condition the loop to meet the higher quality standards that may be required for data transmission.

248. *Methodology for Computing Incremental Cost in Multiproduct Firms*: Common cost and its relationship to incremental cost in multiproduct firms can be more precisely defined as follows using an analysis developed by Faulhaber, Baumol, and others.[655] Under this

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[654] *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676 ("The term 'common costs' refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers).").

[655] *See, e.g.*, Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966, 966-77 (1975). Faulhaber's objective in the paper was to define a test for cross subsidy, which could precisely define the maximum and minimum prices that a regulated firm should be allowed to charge to any subset of customers; WILLIAM J. BAUMOL ET AL., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 351-56 (1982); William J. Baumol, *Minimum and Maximum Pricing Principles for Residual*

approach, one imagines a multiproduct firm in which a forward looking cost function is known, which allows one to compute the "stand alone cost" of any possible subset of products. For example, if the set of products is indexed by the set N = {1, . . . , n}, then the stand alone cost of the entire firm can be represented by the value C(N). The incremental cost of any individual product j contained in N can then be represented by the value IC(j) = C(N) − C(N − j), where C(N − j) represents the stand alone cost of producing every product in the set N except product j. Under this definition, the incremental cost may be viewed as the *additional costs* of adding product j to a firm currently producing products (N − j). Alternatively, it may be viewed as the cost that may be *avoided* if the firm, currently producing products 1 through n, decides not to produce product j. The common cost for the firm as a whole is then equal to $C(N) - \sum_{j \in N} IC(j)$. When there is significant sharing of facilities used in providing groups of services to customers, common costs are typically positive, and may be a significant portion of the firm's total cost.

249. *Multiproduct Incremental Cost versus TELRIC*: In the *Local Competition First Report and Order*, the Commission adopted a pricing methodology, which it called Total Element Long Run Incremental Cost or TELRIC. Under the TELRIC methodology, prices for UNEs and interconnection would be determined by estimating the forward-looking cost of individual network elements, which the Commission defined as "physical facilities of the network, together with the features, func-

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Regulation, in Current Issues in PUBLIC UTILITY ECONOMICS (A. Danielson & D. Kamerschen eds., 1983).

tions, and capabilities associated with those facilities."[656] In adopting the TELRIC methodology, the Commission determined that forward-looking costs should be "based on the least cost, most efficient network . . . technology," assuming current wire center locations.[657] It further determined that the relevant increment should "be the entire quantity of the network element provided."[658] The Commission concluded that "forward-looking common costs shall be allocated among elements and services in a reasonable manner . . . ."[659] In choosing to estimate the forward-looking cost of the entire network element, the Commission acknowledged that, when a requesting carrier leased access to that element, it would have exclusive control over that element.[660]

250. With respect to reciprocal compensation, the Commission determined that "the 'additional cost' of terminating a call . . . primarily consists of the traffic-sensitive component of local switching."[661] Nevertheless, the only non traffic-sensitive cost of the local switch that the Commission required states to exclude was the cost of line ports.[662] Similarly, in the rules that the Com-

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[656] *Local Competition First Report and Order*, 11 FCC Rcd at 15631, para. 258.

[657] *Local Competition First Report and Order*, 11 FCC Rcd at 15848-49, paras. 683-85.

[658] *Local Competition First Report and Order*, 11 FCC Rcd at 15850, para. 690.

[659] *Local Competition First Report and Order*, 11 FCC Rcd at 15852-53, para. 696.

[660] *Local Competition First Report and Order*, 11 FCC Rcd at 15693, para. 385.

[661] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[662] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057. *Cf.* 47 U.S.C. § 51.509(b) (requiring only that line

mission adopted regarding "shared transmission facilities between tandem switches and end offices," the Commission allowed the full forward-looking cost of those facilities to be recovered through usage sensitive charges.[663] Thus, with the exception of requiring recovery of the cost of line ports through flat-rated charges, the Commission's TELRIC rules permitted the full forward-looking cost of the local switch, tandem switch, and shared interoffice transmission facilities, including a reasonable allocation of common costs, to be recovered through usage-based charges. In effect, the Commission's TELRIC methodology permitted average-cost pricing using a forward-looking cost methodology.

251. The TELRIC methodology thus differs significantly from the definition of incremental cost for multiproduct firms proposed by Faulhaber and others. First, unlike TELRIC, the traditional economic approach for determining the incremental cost of a single service excludes all common costs. Second, although the TELRIC methodology is essentially an average cost methodology, the traditional economic approach focuses on identifying the additional forward-looking cost that a network would incur if it provided an additional service—in this case call termination. Under the traditional economic definition, the incremental cost of call termination would be determined by estimating the stand alone cost of a network which incorporates all existing services except call termination (including call origination, switching, etc.) and then subtracting this amount from a comparable estimate of the total cost of providing all the same existing services, including call termination. As should be obvious,

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port costs of the unbundled local switching element be recovered through a flat-rated charge).

[663] 47 U.S.C. § 51.509(d).

the incremental cost of call termination under the traditional economic definition should be significantly lower than that calculated under a TELRIC methodology.

252. *The Relevance of Multi-part Pricing*: One common criticism of incremental cost pricing is that it may not permit a firm to recover its total costs, particularly if there are significant common costs.[664] Economists have pointed out, however, that multi-part pricing regimes can potentially lead to more efficient outcomes than uniform prices set equal to either marginal cost or average cost.[665] For example, if the firm is able to charge a fixed monthly fee and a variable usage charge, then it is possible for the firm to set the usage charge at or close to marginal cost and recover any residual costs through the fixed charge. In this case, the regulator must take account of both subscription and usage elasticities in order to minimize the possibility that higher fixed fees will cause some subscribers to drop off the network.[666] We note that, in the access charge regime, the Commission recognized the efficiencies associated with multi-part pricing, even if it failed to reduce usage-based charges to marginal or incremental cost.

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[664] *See, e.g.*, REGULATION AND MARKETS at 122-23.

[665] *See, e.g., Theory of Public Utility Pricing*, 1 BELL J. ECON. at 117-20; OPTIMAL REGULATION at 191-213.

[666] Demand for subscription is generally estimated to be significantly less elastic than demand for usage. *See* Mercatus Center Sept. 22, 2008 *Ex Parte* Letter at 3 n.15; Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 39 (1999) (estimating elasticity of demand for subscription to be -.005, whereas elasticity of demand for long-distance service is closer to -0.7); *Effects of Breakup of AT&T*, 83 AM. ECON. REV. at 182 (estimating elasticity of demand for basic access at -0.005 and elasticity of demand for long-distance[ ] service between -0.25 and -1.2).

c. The Incremental Cost of Call Termination on Modern Networks

253. We now consider the evidence in the record concerning the incremental cost of terminating calls on modern telecommunications networks. We note at the outset that there appear to be no cost studies or analyses in the record that attempt to estimate the termination costs using Faulhaber's definition of incremental cost. Thus, we would expect the cost estimates in the record to be significantly lower if they had been calculated using Faulhaber's definition.

254. We consider first evidence concerning the cost of termination on modern circuit switches. We note that, in 1996, when the Commission adopted the TELRIC methodology, circuit switches and fiber optic transmission facilities were generally considered the "least-cost, most efficient" currently available technology. And it appears that state commissions in interconnection arbitrations analyzed the forward-looking costs of circuit switches and fiber optic transmission facilities in developing TELRIC rates. Sprint Nextel filed an *ex parte* in which it analyzed state UNE rates for unbundled switching and common transport.[667] Sprint Nextel reports that the national weighted average price per minute for unbundled local switching was $0.00058 (with individual rates ranging from a low of $0.00004 to a high of $0.0061). Similarly the national weighted average price per minute for common transport was $0.00057 (with individual rates ranging from a low of $0.00010 to a high of $0.00727). Sprint Nextel further observes that "the rates for companies in the survey with a relatively small number of lines were

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[667] *See* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter. The data used in the analysis were obtained from the March 2006 "Survey of Unbundled Network Element Prices in the United States."

often lower than the rates for companies with a large number of lines, indicating scale and scope economies do not significantly affect the cost of traffic termination."[668] As Sprint Nextel notes, these rates are all based on the TELRIC methodology and thus represent estimates of average, traffic-sensitive forwarding-looking costs, plus an allocation of common cost and overheads.[669] These estimates, by definition, will significantly exceed incremental cost estimates using the Faulhaber definition; therefore they provide an upper bound on the rates that may result under a Faulhaber approach to incremental cost.

255. Some additional evidence concerning the incremental cost of terminating calls on modern circuit switches can be gleaned from a declaration filed by three economists in support of the Intercarrier Compensation Forum (ICF) plan.[670] The economists contend that modern circuit switches are to a large extent non-traffic sensitive.[671] According to the authors, whereas earlier generations of switching technologies had large shared resources that could be commandeered by any line needing to place or receive a telephone call, most of the resources

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[668] Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter, Attach. at 3-4.

[669] We note that NuVox disputes some of Sprint Nextel's assumptions. *See, e.g.*, Letter from Brad Mutschelknaus & John J. Heitmann, Counsel to NuVox, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 and WC Docket No. 04-36 (filed Oct. 27, 2008) (NuVox Oct. 27 *Ex Parte* Letter). There is insufficient information in the two *ex parte* submissions for us to resolve this dispute. Carriers remain free to raise issues for consideration in the course of state proceedings.

[670] Richard N. Clarke et al., *Economic Benefits from Reform of Intercarrier Compensation (ICF Economists)*, *attached to* ICF *ICC FNPRM* Reply, Errata, App. A.

[671] *ICF Economists* at 22.

in a digital switch are dedicated to individual lines through line ports and trunk ports.[672] In addition, according to the authors, because of the "massive increases in computing power offered by modern microchips," modern circuit switches include "call processing capacity . . . [that] is adequate to serve all reasonably offered demand."[673] In other words, modern switches are designed to be non-blocking, which would suggest that the incremental cost of termination is zero. The declaration thus concludes that the incremental cost of call termination on modern circuit switches should be de minimis.

256. The economists' declaration further argues that the incremental costs of adding additional fiber optic transmission capacity similarly are low. They contend that fiber optic technologies have large fixed costs associated with supporting structures (poles, trenches and conduits) and relatively low incremental costs of increasing the capacity of each fiber cable by installing improved laser transmission equipment (which in many cases is based on technological advances made subsequent to the initial fiber deployment). For these reasons, they conclude that "once a fiber cable has been laid on a route, the costs of increasing its transmission capacity are relatively small, so extra minutes of demand result in very little incremental costs. We note that this analysis suggests, at a minimum, that the incremental cost of adding capacity is significantly less—and likely orders of magnitude less—than the forward looking average cost of capacity, as estimated under TELRIC.

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[672] *ICF Economists* at 20-21.

[673] *ICF Economists* at 21.

257. AT&T submitted evidence that attempts to estimate the incremental cost of a modern softswitch.[674] AT&T maintains that, to estimate the incremental cost of a softswitch, it is necessary to estimate two parameters: the total investment associated with a softswitch, and the percentage of this investment that is traffic-sensitive.[675] Using what it claims are "conservative" estimates, AT&T first compares the estimated investment cost per line of a Class 5 circuit switch with the estimated investment cost per line of a modern softswitch and finds that the investment cost per-line of a softswitch is significantly lower.[676] Although it estimates that the investment cost of a Class 5 switch is approximately $100 per line, it finds that the likely investment cost of a softswitch is between $34 and $80 per line.[677] AT&T then considers the likely percentage of the investment costs per line that are traffic-sensitive, and concludes that, depending on the particular softswitch, the traffic-sensitive costs are likely to be between zero and 20 percent of the total investment cost of the switch.[678] Using the higher estimate of 20 percent traffic-sensitive costs, and assuming that each line carries an average of 1400 minutes a month, AT&T derives a traffic sensitive incremental cost per minute of between $0.00010 and $0.00024.[679] For the other softswitch that AT&T considers, however, the traffic-sensitive incre-

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[674] Letter from Henry Hultquist, Vice President—Regulatory Affairs, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 05-337, 96-45, 99-68, 07-135 (filed Oct. 4, 2008) (AT&T Oct. 4, 2008 *Ex Parte* Letter).

[675] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2.

[676] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3.

[677] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2-3.

[678] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3-4.

[679] AT&T Oct. 4, 2008 *Ex Parte* Letter at 4.

mental costs of termination would be zero. Although we do not necessarily accept the precise estimates contained in AT&T's *ex parte* letter, we note that its analysis suggests that the incremental traffic-sensitive costs of modern softswitches are likely to be significantly lower than those of circuit switches and possibly zero, both because the investment cost per line is lower and because the percentage of traffic-sensitive costs to total costs is lower for modern softswitches.

258. Windstream Communications, Inc. and NuVox subsequently filed ex parte letters criticizing AT&T's analysis of the traffic sensitive costs of a softswitch,[680] and AT&T filed a response.[681] Essentially, both Windstream and NuVox criticize specific elements of AT&T's analysis. In addition, Windstream argues that it would be grossly inefficient for a rural carrier to immediately replace circuit switching equipment with softswitch technology, while NuVox contends that even a forward-looking network design would not consist entirely of soft switches. Significantly, NuVox criticizes AT&T for failing to apply the TELRIC methodology, and NuVox recalculates AT&T's estimates using TELRIC. Because we expressly

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[680] Letter from Eric N. Einhorn, Vice President, Federal Government Affairs, Windstream Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 06-122, 07-135, 08-152 (filed Oct. 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter); Letter from John J. Heitmann, Counsel for NuVox, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Oct. 24, 2008) (NuVox Oct. 24, 2008 *Ex Parte* Letter).

[681] *See* Letter from Henry Hultquist, Vice President Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 07 135 (Oct. 28, 2008) (AT&T's response appears specific to the NuVox Oct. 24, 2008 *Ex Parte* Letter).

reject use of the TELRIC methodology for purposes of setting reciprocal compensation rates, we conclude that many of the NuVox challenges are moot. To the extent that NuVox and Windstream are challenging cost assumptions that may be applied by states pursuant to our new additional costs methodology, such issues may be raised for consideration by the state commission during the cost proceeding to establish the uniform reciprocal compensation rate. We feel compelled, however, to point out a few of the most critical mistakes and misconceptions contained in the Windstream and NuVox ex parte letters.

259. First, Windstream argues that it is somehow inappropriate to consider the additional costs of softswitches in setting termination rates because it would be economically infeasible for an incumbent LEC to replace all its existing circuit switches with softswitches.[682] This argument fundamentally misconstrues the purpose of a forward-looking cost methodology. The adoption of a forward-looking cost standard does not imply in any way that existing carriers should replace fully functional plant and equipment simply because a more recent vintage of replacement equipment is available. Forward-looking costs are simply a measure of the economic value of future investments, and in a competitive marketplace, these values should determine the appropriate investment decisions regarding replacement of existing plant. More importantly, these values should be used as an appropriate guide in setting efficient prices for the utilization of existing plant and equipment. Second, although both Windstream and NuVox raise objections to AT&T's cost analysis, neither they nor AT&T actually attempt to

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[682] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2.

estimate the incremental cost of call termination. For example, both Windstream and NuVox argue that AT&T's estimates of the cost of investment in forward-looking softswitch technologies are flawed because of the assumptions made about the number of lines served per switch.[683] Although this is may be a valid issue, as it relates to the extent to which softswitch technologies are scalable for deployment in wire centers with different numbers of final customers, the dispute does not really address the issue of the incremental cost of call termination. Third, NuVox claims that the absence of line cards in softswitches is evidence that all switch costs are traffic sensitive.[684] This analysis ignores the potentially large fixed costs associated with a softswitch that are not related to line ports. Since softswitches resemble small computers, the appropriate analogy for estimating incremental cost would be the cost of additional memory cards, which could be inserted into the CPU. Fourth, NuVox maintains that both common costs to the firm as a whole and land and building costs associated with switching equipment should be included in any traffic sensitive cost computed for purposes of reciprocal compensation.[685] As explained above, we conclude that common costs should no longer be included in calculating the incremental cost of call termination.

260. Another approach to estimating the incremental cost of call termination is to examine the technology of next generation networks in which voice calls are carried on the same network platform as data and video services delivered to the same customer. Telecommunications

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[683] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2-3; NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 8-9.

[684] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 14-15.

[685] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 18 & n.40.

carriers are currently deploying such networks at a rapid pace, although the transition to the new technology is far from complete. Nevertheless, most experts believe that IP technologies will be used to deliver the predominant share of voice and data traffic within a few years. Packet technologies, and the resulting commingling of voice and data traffic, make possible a dramatic reduction in the cost of originating and terminating voice traffic in the network. In addition, although the costs of circuit based switching technologies are difficult to quantify using public data sources, the Internet itself provides a variety of sources which can be used to provide at least a rough estimate of the costs associated with a next generation network.

261. Consider the case of a single customer who subscribes to a next generation network offering a full range of voice, video and data services. Suppose that this customer makes exactly one voice call lasting five minutes during each hour of the busy period (which we will unrealistically assume to last for 16 hours every day of the month). High quality (ISDN level) voice service requires a channel capacity of 64 kbps. Ignoring the possibility of signal compression, and making a conservative allowance for packet header overhead,[98] we assume that the single call per hour requires a network capacity of 100 kbps. This capacity requirement translates to 12,800 bytes per second, or 0.0000128 Gigabytes to be available for the du-

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[98] *See, e.g.*, VoIP-Info.org, Bandwidth Consumption, http://www.voip-info.org/wiki-Bandwidth+consumption (last visited Oct. 25, 2008); Westbay, Voice over IP Bandwidth, http://www.erlang.com/bandwidth.html (last visited Oct. 24, 2008) (investigating bandwidth requirements for the transmission of voice over an IP based network).

ration of the call.[567] Publicly available estimates of the cost of serving residential customers on a broadband network range from $0.1 Gigabytes per month to $0.5 Gigabytes per month.[568] These estimates include the cost of the servers, routers and fiber links necessary to provide service to the residential customer, but do not include the substantial cost of the local broadband loop.[569] The hypothetical consumer described above places a demand of 0.000512 Gigabytes per month, and using the upper limit on the estimated cost, we estimate a monthly incremental cost to the consumer of delivering this level of voice service at 0.0256 *cents* per month.[570] Under these

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[567] In this analysis, we ignore the additional economies that can result because multiple packet streams for voice traffic can be transmitted simultaneously over the same channel capacity.

[568] The lower estimate is contained in the Wikipedia entry "Broadband Internet Access," http://en.wikipedia.org/wiki/Broadband_Internet_access (last visited Oct. 11, 2008). The higher estimate is contained the trade publication Telephony Online, "OPC: BellSouth Chief Architect warns of HD VOD costs," March 7, 2006, http://telephonyonline.com/iptv/news/BellSouth_VOD_costs_030706 (last visited Oct. 11, 2008). Both estimates are also reported in David Clark, A Simple Cost Model for Broadband Access: What Will Video Cost?, Presentation at the Telecommunications Policy Research Conference (Sept. 28, 2008), *available at* http://tprweb.com/files/Cost%20analysis%20TPRC.pdf.

[569] The cost of the local loop is clearly a common cost that is shared by all of the voice, video, and data services consumed by the subscriber and should not be included under any reasonable definition of incremental cost.

[570] Broadband Internet service is typically priced on the basis of capacity—either the maximum instantaneous upload and download speed or, as in this example, total monthly traffic. A rigorous application of true incremental cost pricing would require measuring each customer's contribution to system costs, which primarily consists of the delays or packet losses imposed on other users. For this purpose, minutes of use are largely irrelevant.

conservative assumptions the cost, on a per-minute basis, would be 0.00001 *cents* per minute.[691] Even if the cost estimates used above are wrong by several orders of magnitude, it is clear that the cost of voice traffic on a broadband network is vanishingly small.[692] Although we are not directing the states to consider the incremental cost of terminating voice telecommunications on such next generation networks,[693] we find that, as carriers move to an all IP broadband world, the incremental costs of terminating voice calls should drop dramatically.

d. Reconsideration of Additional Costs Standard

262. We adopt a new "additional costs" methodology using the traditional economic definition of the incremental cost of a service produced by a multiproduct firm, rather than continuing to rely on the TELRIC methodology.[694] The Supreme Court has made clear that an "'ini-

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[691] These estimated costs do not include the costs of billing, advertising, or other customer care expenses. As with the case of the local loop, we believe that such costs should not be included in any measure of long run incremental cost of call termination.

[692] It is very unlikely that the cost estimates are significantly low. Telecommunications carriers continue to upgrade their networks to provide precisely the range of video and data services that the articles in a previous footnote were concerned with. Indeed, the BellSouth estimate was given with concern that such services would not be viable unless that estimate of cost could be reduced in the near future. Very similar arguments were made exactly 20 years ago in ROBERT M. PEPPER, THROUGH THE LOOKING GLASS: INTEGRATED BROADBAND NETWORKS, REGULATORY POLICY, AND INSTITUTIONAL CHANGE (FCC, OPP Working Paper No. 24, Nov. 1988), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp24.pdf.

[693] *See infra* section V.C.1.

[694] We find it preferable to shift entirely to an approach based on the traditional economic definition of incremental cost, rather than trying to achieve the same result through extensive revisions to the

tial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis,' for example in response to changed factual circumstance, or a change in administrations."[695] Consistent with this, the Commission, in its 2005 *Intercarrier Compensation FNPRM*, solicited comment on whether the Commission should reinterpret "additional costs" to mean "incremental cost" in light of the need to reform intercarrier compensation due to market distortions.[696] In response, several commenters supported such a proposal noting that the additional incremental cost of terminating traffic is de minimis.[697] Based on the evidence highlighted above and for the reasons set forth below, we revise our interpretation of the "additional costs" lan-

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TELRIC methodology as some commenters suggest. *See, e.g.*, Rural Alliance *ICC FNPRM* Comments at 50-54 (calling for a more precise definition of TELRIC for purposes of reciprocal compensation).

[695] *Brand X*, 545 U.S. at 981 (quoting *Chevron U.S.A. Inc. v. Nat'l Res. Def. Council* (*Chevron*), 467 U.S. 837, 863-64 (1984) and citing *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Automobile Ins. Co.* (*State Farm*), 463 U.S. 29, 59 (1983) (Rehnquist, J., concurring in part and dissenting in part)).

[696] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4719, para. 71.

[697] *See, e.g.*, CTIA *ICC FNPRM* Comments at 16 ("Because a call does not impose significant incremental costs on either the calling party's or called party's network, there is no justification for allowing the terminating network to impose any charge on the non-terminating network."); Frontier *ICC FNPRM* Comments at 7 ("However, there is virtually NO additional incremental cost of sending a minute-of-use across [dedicated hardware interfaces]."); Western Wireless *ICC FNPRM* Comments at 16 ("Independent Wireless Carriers urge the Commission to confine its analysis of 'additional cost' only to the incremental traffic-sensitive switching and transport costs actually incurred by the parties exchanging traffic for purposes of intercarrier compensation.").

guage in section 252(d)(2) to mean "incremental costs" as traditionally defined. We believe that this conclusion is supported by the economic theory discussed above, and represents a more appropriate interpretation of the "additional costs" standard than the TELRIC methodology.[698]

263. As an initial matter, the Commission plainly has the authority to revise its interpretation of "additional costs."[699] Indeed, the Supreme Court has recognized that the phrase "additional costs" is ambiguous.[700] Words like additional cost "give ratesetting commissions broad methodological leeway,"[701] and courts owe "substantial deference to the interpretation the Commission accords

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[698] We reaffirm that the TELRIC methodology is appropriate for setting interconnection and network element rates pursuant to section 252(d)(1), where Congress directed the Commission to consider a "reasonable profit."

[699] The Supreme Court affirmed the Commission's authority to apply a cost methodology for the states to implement. *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. *See also id.* at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has."); 47 U.S.C. § 201(b); *United Telegraph Workers, AFL CIO v. FCC*, 436 F.2d 920, 923 (D.C. Cir. 1970) (citations and quotations omitted) (finding that section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act").

[700] *See Verizon v. FCC*, 535 U.S. at 499-501 ("[W]ithout any better indication of meaning than the unadorned term, the word 'cost' in section 252(d)(1), as in accounting generally, is 'a chameleon,' a 'virtually meaningless' term . . . .") (citations omitted).

[701] *See Verizon v. FCC*, 535 U.S. at 499-501 (quoting *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 423 (Breyer, J., concurring in part and dissenting in part)).

them."[702] The Commission, consistent with its obligation to "consider varying interpretations and the wisdom of its policy on a continuing basis" now revises its definition of "additional costs."[703]

264. Revising our interpretation of "additional costs" to follow the traditional economic definition of the incremental cost of a service is supported by the Commission's interpretation of the term "additional costs" in section 224 of the Act. Section 224, which addresses the pricing of pole attachments, is the only other place in the Act that uses the term "additional costs." The Commission consistently has found that the term "additional costs" in section 224 means incremental cost,[704] and that the legislative history for section 224 makes clear that Congress intended such a result.[705] Interpreting the term "additional costs" as used in two parts of the Act in the same manner is consistent with the "presumption that identical

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[702] *Capital Network System, Inc. v. FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994).

[703] *Brand X*, 545 U.S. at 981 (quoting *Chevron*, 467 U.S. at 863-64 and citing *State Farm*, 463 U.S. at 59 (Rehnquist, J., concurring in part and dissenting in part)).

[704] *See, e.g., Adoption Of Rules For The Regulation Of Cable Television Pole Attachments*, CC Docket No. 78-144, Memorandum and Opinion and Second Report and Order, 72 FCC 2d 59, 62, para. 8 (1979); *Adoption Of Rules For The Regulation Of Cable Television Pole Attachments*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d 3, 15, App. (1978) (*Cable Television Pole Attachment NPRM*).

[705] *Cable Television Pole Attachment NPRM*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d at 15, App. ("'Additional costs' are generally equivalent to what is referred to as incremental cost, and the proportional part of 'Operating expenses and actual capital costs' are generally equivalent to fully allocated costs." (quoting S. REP. NO. 95-580 at 19-21 (1977)).

words used in different parts of the same act are intended to have the same meaning."[706]

265. In contrast, the statutory pricing standard for reciprocal compensation ("additional costs") is not the same as the statutory pricing standard for UNEs ("cost" plus "a reasonable profit").[707] Even though the two statutory provisions may, as the Commission found previously, be "similar," our subsequent experience indicates that TELRIC is not consistent with the "additional costs" standard. First, as discussed above, evidence indicates that reciprocal compensation rates based on TELRIC methodology were "excessive."[708] If reciprocal compensation rates truly reflected the incremental "additional costs," regulatory arbitrage should not occur because a carrier would not make a profit by recovering its incremental cost.[709]

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[706] *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

[707] *Compare* 47 U.S.C. § 252(d)(1) *with* 47 U.S.C. § 252(d)(2).

[708] *See, e.g., Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4694, 4697-98, 4717, 4719, paras. 16, 23-24, 66, 71-72; *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616-18, paras. 11-18; *ISP Remand Order*, 16 FCC Rcd at 9161-62, paras. 18-20.

[709] For the same reasons, we reject suggestions that TELRIC should be used to set a unified rate for intercarrier compensation. *See, e.g.*, Ohio PUC *ICC FNPRM* Comments at 20 ("[T]he Ohio Commission recommends the use of the TELRIC standard for setting intercarrier compensation rates."); Pac West et al. *ICC FNPRM* Comments at 9 ("The 'additional cost' standard should continue to be tied to TELRIC"); Time Warner Telecom et al. *ICC FNPRM* Comments at 1-2 ("[A] central component of reform must be the requirement that, to the extent possible, each carrier charge a single, cost-based rate for the exchange of all types of traffic. . . . [T]he Commission arguably has the authority to mandate that states use a cost-based methodology, in particular TELRIC, as the basis for setting all intercarrier termination rates."); Integra *ICC FNPRM*

266. Second, TELRIC includes the cost of the "total element" and, as a result, measures the long run incremental average cost of the switch including common costs and overhead, not just the additional costs of using the function to terminate another carrier's traffic. In other words, TELRIC measures the *average* cost of providing a function, which is not necessarily the same as the *additional* costs of providing that function. Because of this, we expect that the TELRIC methodology would continue to produce reciprocal compensation rates above the true "additional costs" of terminating such traffic, in light of evidence that the cost of terminating traffic today is low[710] and is decreasing even further as carriers transition to softswitches[711] and ultimately pure packet switches. Consistent with our change in methodology, we also disavow our finding in the *Local Competition First Report and Order* that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on

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Comments at 3 ("Integra urges the Commission to . . . [u]nify access and reciprocal compensation rates at TELRIC based levels on a company-by-company basis."); KMC and Xspedius *ICC FNPRM* Reply at 3 ("[T]he Commission should support tariffed-based intercarrier compensation arrangements that: (i) set rates no higher than the comparable TELRIC (or similar cost-based) rates."); XO *ICC FNPRM* Reply at 11 ("[T]he only appropriate intercarrier compensation regime must include TELRIC-based rates.").

[710] The national average of TELRIC rates for transport and termination of calls was $0.00212 in 2004, which likely overstates the actual incremental costs because, as noted above, TELRIC includes common and overhead costs and examines the average cost of the function, not the additional cost of terminating traffic. Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Sept. 2, 2004) (CBICC Sept. 9 *Ex Parte* Letter); *see also* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter.

[711] *See* T-Mobile *ICC FNPRM* Comments at 29-30.

a usage-sensitive basis constitutes an "additional costs" to be recovered through termination charges."[712] In particular, as explained above, we specifically exclude common costs and overhead allocations from the calculation of what constitutes "additional costs" under our new pricing methodology.

267. We thus end our reliance on the TELRIC methodology for setting reciprocal compensation rates, and instead require that such rates be set pursuant to our new incremental cost methodology.[713] In our Implemen-

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[712] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[713] A number of parties advocate for or against Commission adoption of bill-and-keep for intercarrier compensation. *See, e.g.*, Letter from Jonathan Askin, Counsel for FeatureGroup IP, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3-4 (filed Oct. 7, 2008); Letter from Paul W. Garnett, Assistant Vice President of Regulatory Affairs, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Oct. 7, 2008); Corr *ICC FNPRM* Comments at 8; Cox *ICC FNPRM* Comments at 8-9; ICF *ICC FNPRM* Comments at 26, 30; Western Wireless et al *ICC FNPRM* Comments at 6-8. *But see, e.g.*, Letter from Tamar E. Finn, Counsel for PAETEC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 10 (filed Oct. 7, 2008) ("Mandatory Bill-and-Keep Is Not A Viable or Fair Solution"); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Cavalier Telephone et al,, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 3, 2008) ("[T]he adoption of mandatory bill-and-keep arrangements is extremely ill advised as a policy matter."); BellSouth *ICC FNPRM* Comments at 9 ("[A] plan to transition rates ultimately to bill-and-keep would not promote economic efficiency or preserve universal service, nor is bill-and-keep competitively neutral."); CCG Consulting Inc. (CCG) *ICC FNPRM* Comments at 7 ("[A]ccess rates should not be reduced to zero through implementation of a Bill and Keep mechanism."); CenturyTel *ICC FNPRM* Comments at 4 ("... CenturyTel unequivocally opposes replacing intercarrier compensation with a "bill and keep" regime."); CCAP *ICC FNPRM* Comments at 11 ("The CCAP urges the Commission

tation section below, we provide specific guidance to the states regarding how to apply this new methodology. We note that this Commission takes seriously its responsibility to ensure that rates for carriers are just, reasonable, and not confiscatory. In this order, we have set in motion mechanisms to help ensure that the financial viability of carriers will not be undermined. We feel confident that these mechanisms, in combination with the other avenues available for carriers to offset declines in access revenues, will be sufficient to achieve this result.[714]

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to avoid implementation of a bill and keep regime . . . ."); Frontier *ICC FNPRM* Comments at 6 (arguing that bill and keep is inappropriate because it does not account for asymmetric traffic patterns); SBA *ICC FNPRM* Comments at 7 (arguing that bill-and-keep is inappropriate between rural and larger LECs due to various asymmetries). We believe the reforms we adopt here are preferable to a pure bill-and-keep requirement and more appropriately balance the interests of consumers and carriers at this time. The approach we adopt in this order avoids the need to resolve disputes in the record regarding bill-and-keep in various circumstances because it allows parties to advocate for such an approach before state commissions and parties may negotiate such arrangements.

[714] Some carriers have suggested that our changes in ratemaking methodology will necessarily produce confiscatory rates and constitute a taking. *See, e.g.*, NTCA, Interim Universal Service & Intercarrier Compensation Reform Proposal (NTCA Interim Proposal) at 19-22, *attached to* Letter from Daniel Mitchell, Vice President, Legal & Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92 (filed Oct. 6, 2008) (NTCA Oct. 6, 2008 *Ex Parte* Letter) (contending that the Commission's current access regime, not to mention any reductions in access rates, threatens rate-of-return carriers with unconstitutional takings). *See also* Cincinnati Bell *ICC FNPRM* 11-12 ("The elimination of interstate switched access charges without an opportunity to earn the revenue in another fashion could be confiscatory . . . ."); GVNW Consulting *ICC FNPRM* Comments at 9 ("The existing system of cost recovery consisting of three equally important components of access charges, universal service support, and local rates is the only

268. Moreover our decision to adopt a unified intercarrier compensation methodology is in no way arbitrary or adopted with any confiscatory purpose. In fact, the determinations made in this order reveal just the contrary, our decision to raise the cap on SLCs, our referral to the Federal-State Joint Board on Separations (Separations Joint Board) of the issue of whether to allow additional increases in SLC caps in Part V.C below, and our acknowledgment of the ability of a carrier to establish entitlement to supplemental universal service to help ensure that carriers can maintain their financial integrity.[715] Although in most cases the rates for intrastate and interstate terminating access will drop substantially, that alone is not the test for whether a taking has occurred; rather, a primary consideration for takings claims is whether the rates ultimately adopted will produce a reasonable return sufficient to enable a company to maintain its financial integrity.[716]

C. Implementation

269. In this section, we detail certain implementation items. First, we provide guidance to states with regard

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approach available to the Commission that will enable it to avoid valid claims of confiscation."). This argument lacks merit. Faced with a similar challenge to the TELRIC methodology previously adopted by the Commission, the Supreme Court stated unequivocally that "this Court has never considered a taking challenge on a ratesetting methodology without being presented with specific rate orders alleged to be confiscatory . . . ." *Verizon v. FCC*, 535 U.S. at 524 (citations omitted).

[715] *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) ("Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return . . . .").

[716] *FPC v. Hope Natural Gas Co.*, 320 U.S. at 605.

to their implementation responsibilities for the intercarrier compensation regime we adopt today. Importantly, this includes setting reciprocal compensation rates using the new incremental cost pricing methodology. We also provide guidelines for the states' application of the modification and suspension provisions of section 251(f)(2) of the Act. We explain the need to require symmetrical compensation arrangements without any exceptions under section 252(d)(2)(A)(ii) of the Act. And we discuss the effect of our intercarrier compensation reforms on existing interconnection and commercial agreements. Finally, we address the extent to which reduced revenue from carrier-to-carrier charges may be replaced through end-user charges or new universal service support, where needed.

1. Direction to the States

270. We set forth the timeline for states to implement our comprehensive reform and adopt an interim, uniform reciprocal compensation rate along with a transition plan in section [III.B.2] above. In this section, we set forth additional parameters for states to follow in implementing the reforms adopted in this order.

a. Setting Final Reciprocal Compensation Rates Based on Incremental Cost

271. Under our new methodology for setting final reciprocal compensation rates, states will need to set prices according to a forward-looking economic cost study or computer cost model using the Faulhaber principles to identify the traffic-sensitive incremental cost of transport and termination of traffic.[717] First, states will need to

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[717] We recognize that the incremental cost of terminating traffic may include certain non-traffic-sensitive costs, such as the cost of a trunk port. Consistent with cost-causation principles, however, such non-traffic-sensitive costs may not be recovered through per-minute

evaluate a forward-looking economic cost analysis of a stand-alone network that performs all functions of a modern telecommunications network, including transport and termination of other carriers' traffic. Second, states will need to evaluate a forward looking economic cost analysis of a stand-alone network that performs all the same functions except for the transport and termination of other carriers' traffic. Third, states must compare the costs of these two networks. The difference between the costs of the two networks is the additional costs of termination of traffic subject to the "additional costs" standard we adopt in this order.[718]

272. We offer further guidance regarding specific aspects of these cost studies. First, these cost studies must use the least cost, most efficient network technology. We find that the least cost, most efficient switch today is a softswitch.[719] We further find that the least cost, most efficient technology for transport is fiber optic cable.[720] We observe that, when carriers deploy fiber, they typically deploy capacity significantly in excess of current needs.[721]

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charges, but must rather be recovered through flat-rated monthly charges associated with interconnection trunks.

[718] *See supra* section V.B.4.c.

[719] *See supra* section V.B.4.c.

[720] *See supra* section V.B.4.c.

[721] *See, e.g., Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156, 20237, para. 186 (1999) (subsequent history and citation omitted) ("As we explained in the *Inputs Further Notice*, in determining appropriate cable sizes, network engineers include a certain amount of spare capacity to accommodate administrative functions, such as testing and repair, and some expected amount of growth."); *Triennial Review Order*, 18 FCC Rcd at 17166, para. 312

273. Second, consistent with the traditional economic definition of the incremental cost of a service,[722] the cost studies must exclude all common costs, including overhead costs. Third, all non-traffic-sensitive costs must be excluded from the cost studies.[723] Cost studies using the TELRIC methodology do not meet these requirements, given the differences between TELRIC and the traditional economic methodology for determining the incremental cost of a service discussed above.[724] Available evidence suggests that the incremental costs of terminating traffic, as determined using this methodology, are likely to be extremely close to zero.

274. We also require each state to set a single, uniform rate for all carriers in that state through their pricing proceedings. We find this approach warranted for several reasons. First, softswitches are easily scalable, and thus the incremental cost of termination does not vary with the number of lines the switch serves. Second, because carriers tend to deploy significant excess capacity when deploying fiber, the incremental cost of adding traffic is likely to approach, or equal, zero. Third, we find that setting a single uniform rate for all incumbent LECs and interconnecting carriers in a state simplifies the regulatory process, minimizes arbitrage that could arise, and reduces the likelihood that unidentifiable traffic

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n.919 (citing evidence that "the first carrier to lay fiber to a particular location will lay significantly more than it will need because the incremental cost of burying additional fibers is negligible").

[722] *See supra* section V.B.4.c.

[723] We thus go beyond the requirement in the *Local Competition First Report and Order* that only required states to exclude the cost of line ports, *see* 11 FCC Rcd at 16025, para. 1057, and mandate that *all* non-traffic sensitive costs be excluded.

[724] *See, e.g., supra* section V.B.4.c.

would remain a problem. Finally, setting rates based on the costs of the current, least cost, most efficient technology creates incentives for carriers with less efficient networks to migrate more quickly to those more efficient technologies.

275. Following the transition, once carriers are charging the final uniform reciprocal compensation rate, we establish the following default rules regarding the network "edge."[725] These default rules would not require changes to physical points of interconnection, but would simply define functions governed by a uniform terminating rate.[726]

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[725] *See* Letter from Hank Hultquist, AT&T Services, Inc., and Donna Epps, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 (filed Oct. 14, 2008) (AT&T and Verizon Oct. 14, 2008 *Ex Parte* Letter) (providing seven default rules). We reject PAETEC's assertion that the Commission lacked notice to adopt such rules. *See* Letter from Jonathan S. Frankel and Michael A. Romano, Counsel for PAETEC, CC Docket Nos. 99-68, 01-92 at 2-3 (Oct. 28, 2008) (PAETEC Oct. 28, 2008 *Ex Parte* Letter). The Commission expressly sought comment on this issue in the *Intercarrier Compensation FNPRM*. *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4687, 4702-03, 4712-13, 4727-30, paras. 4, 34, 40-44, 54, 91-97.

[726] Thus, the default "edge" rule we adopt today does not alter any obligations of incumbent LECs' to interconnect at any technically feasible point, nor does the rule alter carriers' ability to request interconnection. *See, e.g.*, Letter from Susanne A. Guyer, Verizon, to Chairman Kevin J. Martin, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 05-337, 06-112 at 5 (filed Oct. 5, 2008). *See also, e.g.*, PAETEC Oct. 28, 2008 *Ex Parte* Letter at 5-6 (expressing concern that the adoption of rules regarding a network "edge" not alter existing rules and obligations regarding physical interconnection). Moreover, the "edge" rules we adopt, which will apply at the end of the transition period, are merely a default, and carriers are free to negotiate alternative arrangements.

- For every call, the calling party service provider (e.g., the calling party's LEC for a local call or the calling party's IXC for a long distance call) is responsible for the transmission and routing of the call to the network edge of the called party service provider.
- The calling party service provider may fulfill its responsibility for the transmission and routing of a call to the called party service provider network edge via its own facilitates and services, the facilities and service of another entity (including the called party's service provider), or any combination.
- The calling party service provider is also responsible for the payment of the uniform terminating rate to the called party service provider. The called party service provider is responsible for performing all network functions to deliver traffic from the network edge to the called party, including dedicated transport, common transport, tandem switching, end office switching, and SS7 messaging.
- The reciprocal compensation regime of section 251(b)(5) will apply to traffic from the called party service provider network edge to the called party.
- The called party service provider's network edge is the location of its end office, MSC, point of presence, or trunking media gateway, which PSTN routing conventions (e.g., NPAC or LERG) associate with the called party telephone number unless that location subtends a tandem switched owned or controlled by the called party service provider, in which case that tandem is the network edge for that call. A service provider that utilizes a tandem as its edge may require, upon reasonable request consistent with standard industry network interconnec-

tion principles, that calling party service providers groom their traffic onto segregated trunk groups.

- The called party service provider must either permit interconnection at its edge for purposes of exchanging traffic with the calling party service provider or provide transport at no charge to that edge from a location in the same LATA where it does permit such interconnection.
- The calling party service provider may at its sole discretion choose whether to interconnect directly or indirectly with the called party service provider.

b. Symmetry

276. We conclude that final uniform reciprocal compensation rates should be symmetrical.[727] In contrast to the approach taken in the *Local Competition First Report and Order*, we require, for the reasons described below, symmetry in all cases once the final uniform reciprocal compensation rates become effective.

277. *Background.* In the *Local Competition First Report and Order*, the Commission concluded that charges for reciprocal compensation were to be presumptively symmetrical and that it was "reasonable to adopt the incumbent LEC's transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination."[728] The

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[727] "Symmetrical compensation arrangements are those in which the rate paid by an incumbent LEC to another telecommunications carrier for transport and termination of traffic originated by the incumbent LEC is the same as the rate the incumbent LEC charges to transport and terminate traffic originated by the other telecommunications carrier." *Local Competition First Report and Order*, 11 FCC Rcd at 16031-32, para. 1069.

[728] *Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085. The Commission provided the following findings

Commission observed that "[b]oth the incumbent LEC and the interconnecting carriers usually will be providing service in the same geographic area, so the forward-looking economic costs should be similar in most cases."[729] Moreover, by using the incumbent LEC's costs of transport and termination, the Commission found that symmetry would provide an incentive for interconnected carriers to minimize costs because if the interconnected carrier could reduce its costs below the costs of the incumbent LEC, then it could realize additional termination revenue.[730] Symmetrical compensation also provided the incumbent LECs an incentive to minimize costs. The Commission further found that symmetry reduced incumbent LECs' bargaining strength because asymmetrical rates could have allowed incumbent LECs to negoti-

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supporting its conclusion: (1) "using the incumbent LEC's forward-looking costs for transport and termination of traffic as a proxy for the costs incurred by interconnected carriers satisfies the requirements of section 252(d)(2)" and "is consistent with section 252(d)(2)(B)(ii)"; (2) "[i]f both parties are incumbent LECs, . . . the larger LEC's forward-looking costs should be used to establish the symmetrical rate for transport and termination"; (3) "larger LECs are generally in a better position to conduct a forward-looking economic cost study"; (4) "imposing symmetrical rates based on the incumbent LEC's additional forward-looking costs will not substantially reduce carriers' incentives to minimize those costs"; and (5) "states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch." *Id.* at 16040-42, paras. 1085-86, 1090.

[729] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085.

[730] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1086 ("A symmetric compensation rule gives the competing carriers correct incentives to minimize its own costs of termination because its termination revenues do not vary directly with changes in its own costs.").

ate high charges for traffic terminating on their networks and low charges for traffic originating on their networks, citing as an example incumbent LECs' treatment of CMRS providers.[731] A presumption of symmetric rates was administratively efficient and did not require a competing carrier to conduct a forward-looking cost study to enter the market, lowering the cost of entry and thus increasing competition.[732]

278. The Commission, however, carved out an exception to the presumption of symmetry. In the *Local Competition First Report and Order*, the Commission permitted interconnecting carriers to rebut the presumption of symmetry by submitting a forward-looking cost study to show that their costs of termination were higher than the incumbent LEC's.[733] If the interconnecting carrier established that "the costs of efficiently configured and operated systems [were] not symmetrical," the state commission could adopt a "different compensation rate" for the interconnecting carrier.[734]

279. *Discussion.* We now require symmetric rates and conclude that the exception that permitted asymmetric rates under certain circumstances is no longer war-

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[731] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041, para. 1087 (noting that incumbent LECs have used their greater bargaining power to negotiate asymmetrical rates with CMRS providers and to charge CMRS providers origination, as well as termination, charges).

[732] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041-42, para. 1088.

[733] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

[734] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

ranted.[735] We note that there is scant evidence of any competitive LECs seeking to establish their own, higher, costs during the last 12 years, let alone being successful in doing so.[736] We conclude that asymmetric rates could undermine the comprehensive reform we adopt by permitting different termination rates for traffic in the same geographic area, which could open the door for continued regulatory arbitrage and thwart the intended public interest benefits associated with reforming the patchwork of existing intercarrier compensation payments.

280. As noted above, symmetrical rates promote efficiency. Symmetry will encourage interconnecting carriers to deploy more efficient technology to reduce their costs. Notably, the Commission of the European Communities (European Communities) has also found that divergent regulatory treatment between different technology termination rates, as this rebuttable presumption

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[735] We note that the rates that will apply under our transition plan, discussed *supra* Part V.B.2, will not necessarily be symmetric. For example, we do not permit CMRS providers to assess access charges during the transition. *See supra* para. 197; 47 U.S.C. § 251(f)(2). Our symmetry rules thus apply outside the transition framework, i.e., for carriers exchanging traffic at the final, uniform reciprocal compensation rate, or for carriers that have received a suspension or modification of our intercarrier compensation requirements pursuant to 251(f)(2).

[736] Indeed, we are only aware of one case where a competitive LEC attempted to rebut the presumption and, in that case, the state commission found that the competitive LEC had failed to do so. *See* Petition of Sprint Spectrum L.P. d/b/a Sprint PCS, Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Intercarrier Agreement with Verizon New York Inc., Case 01-C-0767, Arbitration Order, 2002 WL 31505732 (N.Y. P.S.C. 2002) (holding that Sprint did not rebut the presumption that its costs were higher than the incumbent LEC's).

exception allows, creates distortions among markets.[737] In the context of fixed versus mobile telephony, the European Communities recognized that some European countries have allowed smaller CMRS carriers to charge higher termination rates to compensate for these carriers' lack of economies of scale.[738] The European Communities concluded that these higher termination rates for mobile technology led to higher retail rates for customers and lower usage of this technology.[739] As the European experience shows, allowing the present exception to the symmetry rule could encourage higher termination rates, and asymmetric termination rates—particularly if such termination rates were high for one carrier—could reduce consumer welfare and lead to higher prices.

281. We conclude that requiring symmetrical compensation arrangements without any exceptions is proper under section 252(d)(2)(A)(ii) of the Act.[740] We also con-

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[737] *See* THE COMMISSION OF THE EUROPEAN COMMUNITIES, DRAFT COMMISSION RECOMMENDATION ON THE REGULATORY TREATMENT OF FIXED AND MOBILE TERMINATION RATES IN THE EU 3, para. 3 (2008), *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/termination_rates/termination.pdf (last visited Oct. 24, 2008) (EUROPEAN COMMUNITIES).

[738] *See* EUROPEAN COMMUNITIES at 2, para. 2.

[739] *See* EUROPEAN COMMUNITIES at 3, para. 3.

[740] This section requires that, in setting rates under interconnection agreements, states must ensure that reciprocal compensation charges are a "reasonable approximation of the additional costs of terminating such calls." *See* 47 U.S.C. § 252(d)(2)(A)(ii). In the *Local Competition First Report and Order*, the Commission found that the incumbent LEC's costs were a reasonable proxy for other carriers' costs. 11 FCC Rcd at 16040, para. 1085. We reaffirm that finding, especially given that our pricing methodology focuses on the costs of the least cost, most efficient network technology. Moreover, per the express terms of the Act, the "additional costs" standard applies only to the costs of the incumbent LEC, not the competitive

firm that this mandatory symmetry requirement applies without regard to whether traffic exchanged by the interconnected carriers is balanced or not. Given the substantial benefits of symmetrical rates as described above, the likelihood that allowing asymmetrical rates would give carriers an incentive to find ways to arbitrage the higher rates, and the minimal costs associated with terminating calls,[741] we find that an exception to symmetrical rates where traffic is out of balance is not warranted.

c. Modifications and Suspensions under Section 251(f)(2)

283. In light of the importance of bringing uniformity and symmetry to intercarrier compensation, eliminating opportunities for regulatory arbitrage, and providing regulatory certainty to carriers in making investment plans, we find it appropriate to adopt guidelines regarding the application of section 251(f)(2). Section 251(f)(2) of the Act gives state commissions the ability to suspend or modify our intercarrier compensation rules implementing section 251(b) and (c) under certain conditions. Specifically, section 251(f)(2) of the Act permits a "local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide" to "petition a State commission for a suspension or modification of the application of a requirement or re-

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LEC. This interpretation of the Act promotes efficiency and therefore bolsters competition, consistent with the goals of the Act. *See* 1996 Act, Preamble (declaring the purpose of the Act to be "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").

[741] *See supra* section V.B.4.c.

quirements of [section 251] (b) or (c)."[742] The state commission shall grant such petition "to the extent that, and for such duration as, the State commission determines that such suspension or modification (A) is necessary (i) to avoid a significant adverse economic impact on users of telecommunications services generally; (ii) to avoid imposing a requirement that is unduly economically burdensome; or (iii) to avoid imposing a requirement that is technically infeasible; and (B) is consistent with the public interest, convenience, and necessity."[743] In the *Local Competition First Report and Order*, the Commission "decline[d] . . . to adopt national rules or guidelines" regarding the specific implementation of section 251(f), but explained that the Commission "may offer guidance on these issues at a later date, if we believe it is necessary and appropriate."[744] The Supreme Court subsequently confirmed that the Commission has the authority to interpret section 251(f).[745] The only existing Commission guideline regarding section 251(f)(2) provides that the burden of proof is on the LEC seeking suspension or modification of particular requirements.[746]

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[742] 47 U.S.C. § 251(f)(2).

[743] 47 U.S.C. § 251(f)(2).

[744] *Local Competition First Report and Order*, 11 FCC Rcd at 16118, para. 1263; 47 U.S.C. § 251(f)(2).

[745] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

[746] *See* 47 C.F.R. § 51.405(b). In the *Local Competition First Report and Order*, the Commission held that, in petitions under section 251(f)(2), "a LEC must offer evidence that application of those requirements would be likely to cause undue economic burdens beyond the economic burdens typically associated with efficient competitive entry." 11 FCC Rcd at 16118, para. 1262. The Commission also placed the burden of proof on the carrier seeking the relief under section 251(f)(2). *Id.* at 16118, para. 1263. Although the Supreme Court ultimately upheld the Commission's authority to interpret sec-

283. As an initial matter, we conclude that any suspension or modification granted pursuant to section 251(f)(2) must be for a limited "duration" and cannot be indefinite. This interpretation follows directly from the express language of section 251(f)(2). Specifically, section 251(f)(2) provides that the state should grant a suspension or modification "to the extent that, *and for such duration as*, the State commission determines that such suspension or modification"[747] satisfies the statutory test. Congress thus expected that the conditions warranting suspension or modification of a requirement would not be permanent, and it permitted the states to continue such modifications or suspensions only for a particular "duration," rather than remaining in place indefinitely. In contrast, Congress adopted the opposite approach in section 251(f)(1), where it provided a default exemption for "rural telephone companies" from section 251(c) that continues indefinitely "until" certain statutory criteria are met.[748] Accordingly, we conclude that the LEC requesting the suspension or modification under section 251(f)(2) has the burden of demonstrating the appropriate duration of any suspension or modification. To the extent that a state

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tion 251(f), *see AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385, the Eighth Circuit subsequently vacated the Commission's interpretation of "undue economic burden," finding that the Act requires a state to look at the entire economic burden not just the additional burden of complying with sections 251(b) or 251(c). *See Iowa Utils. II*, 219 F.3d at 759-62. The Eighth Circuit also found that the Commission erred in placing the burden of proof on the rural LEC when a requesting carrier seeks to remove the section 251(f)(1) exemption from section 251(c). The Eighth Circuit therefore vacated sections 51.405(a), (c), and (d) of our rules, *id.* at 762, but did not disturb the allocation of burden of proof under section 251(f)(2) as set forth in 47 C.F.R. § 51.405(b).

[747] 47 U.S.C. § 251(f)(2) (emphasis added).

[748] 47 U.S.C. § 251(f)(1).

grants a suspension or modification for a particular duration, the Commission encourages the state to impose a timeline or other requirements on the LEC to ensure that it is taking concrete steps to enable it to comply with the relevant requirements once the suspension or modification ends.[749] If a state finds that a LEC is not taking such steps necessary to ensure compliance on a date certain, we find that such a determination would be sufficient for the state immediately to revoke the suspension or modification as no longer satisfying the "public interest" criteria.

284. We also offer guidance regarding the substantive standards that state commissions must apply when evaluating requests pursuant to section 251(f)(2) for a suspension or modification of section 251(b) or (c). The first prong of section 251(f)(2)(A) directs state commissions to determine whether the LEC establishes that absence of the requested suspension or modification would cause a "*significant* adverse economic impact on users of telecommunications services generally."[750] The term "significant" is ambiguous. According to Webster's Dictionary, "significant" means "having or likely to have influence or effect; of a noticeably or measurably large amount."[751] We find this to be a reasonable definition, and conclude that for an "adverse economic impact" to be "significant" requires that such harm be "measurably large." Moreover, the state commission must evaluate the net impact "on users of telecommunications services

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[749] Moreover, if, in the future, we have evidence that states are granting arbitrarily long suspensions/modifications to requesting LECs, the Commission will consider imposing a limit on the number of years that a suspension/modification is appropriate.

[750] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[751] WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1096 (1991).

generally."[752] We conclude that state commissions must consider users of telecommunications services more broadly, rather than focusing narrowly on impacts on isolated groups of users, such as customers of the LEC requesting the suspension or modification. Further, state commissions must weigh the overall impact on such users, including not only any adverse impacts on particular users, but whether there are other associated benefits of the regulatory requirements to telecommunications users. For example, the reduction in intercarrier compensation payments might lead some carriers to increase some rates, but also should reduce long distance rates, stimulate additional competition in local markets, consistent with the goals of the 1996 Act, and provide additional benefits to end users. We direct states to consider the totality of the circumstances in evaluating the impact on telecommunications users.

285. The second prong of section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that the requested suspension or modification is necessary to "avoid imposing a requirement that is unduly economically burdensome."[753] The Eighth Circuit has interpreted the phase "unduly economically burdensome" to require a state to examine "the full economic burden on the ILEC."[754] Consistent with this interpretation, and our interpretation of section 251(f)(2)(A)(i)

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[752] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[753] *See* 47 U.S.C. § 251(f)(2)(A)(ii).

[754] *Iowa Utils. II*, 219 F.3d at 761. The Commission initially interpreted undue economic burden to mean the "undue economic burden beyond the economic burden that is typically associated with efficient competitive entry." 47 C.F.R. § 51.405(d). The Eighth Circuit vacated this reading of the statute. *See Iowa Utils. II*, 219 F.3d at 760-61.

above, we conclude that states must evaluate the totality of the circumstances in evaluating the net burden. For example, in evaluating the impact of section 251(b)(5) as we interpret it today, states cannot simply look at the LEC's loss of intercarrier compensation revenues. Rather, the state must consider the full economic impact on the LEC of all the comprehensive reforms we adopt, including the ability of carriers to recover revenues by raising other rates, including the federal SLC, the potential economic savings due to reduced billing costs, fewer disputes and litigation regarding the classification of traffic, and the possibility that a carrier may receive universal service support if its financial integrity is threatened.

286. The third prong under section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that compliance with section 251(b) or (c) may be "technically infeasible."[755] We do not believe that any carrier will be able to establish that implementation of our intercarrier compensation reforms is "technically infeasible," considering that carriers generally are exchanging and billing for traffic today, and our rules adopted in this order should merely simplify this process. Thus, we recommend that state commissions scrutinize rigorously any claims of technical infeasibility, particularly if the LEC is paying and/or receiving intercarrier compensation today.

287. Even if a state finds that a LEC satisfies the requirements for a temporary suspension or modification under section 251(f)(2)(A), section 251(f)(2)(B) provides that a state commission cannot grant a petition for suspension or modification unless it also finds that granting the requested petition is "consistent with the public in-

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[755] 47 U.S.C. § 251(f)(2)(A)(iii).

terest, convenience, and necessity."[756] In light of the compelling need to adopt comprehensive reform of existing intercarrier compensation regimes as described above,[757] the Commission urges states to use caution and consider carefully the ramifications of granting any suspension or modification, particularly regarding petitions seeking relief from section 251(b)(5). Indeed, any suspension or modification that continues to treat traffic under different rate structures opens the door for continued regulatory arbitrage and disputes. Such action would undermine the tremendous public interest benefit associated with treating all traffic the same.

288. The Act is silent on what occurs if a state grants a suspension or modification of the section 251(b) or (c) obligations. We find that this silence creates ambiguities and could lead to inconsistent results following a modification or suspension under section 251(f)(2). We are concerned that a suspension or modification of section 251(b)(5) could result in exactly the kind of disparate treatment that we intend to correct with our actions today. Pursuant to our authority under section 201(b), as well as our authority to interpret section 251(f),[758] we therefore adopt rules specifically addressing certain of the implications of a suspension or modification of our intercarrier compensation rules.[759]

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[756] 47 U.S.C. § 251(f)(2)(B).

[757] *See supra* section V.A.3.

[758] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

[759] Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act." 47 U.S.C. § 201(b); *see also* 47 U.S.C. § 154(i) ("The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its func-

289. First, to minimize inconsistency and the possibility that the reforms we adopt today could be undermined, we extend our symmetry requirement for reciprocal compensation rates at the end of the transition period described in Part V.B to any suspension or modification of our section 251(b)(5) reciprocal compensation rules and requirements. If a LEC receives a suspension or modification of our reciprocal compensation pricing methodology, for example, all other LECs and CMRS providers that exchange traffic with the LEC receiving the suspension or modification will likewise be entitled to charge that LEC those same rates that the LEC charges them for the duration of such suspension or modification. We conclude that this symmetry requirement is in the public interest and will reduce disputes, arbitrage, and transaction costs. Indeed, a contrary result that would permit different terminating rates in the same geographic area would not be in the public interest and likely would lead to the same disputes we have today. If a state attempts to avoid this symmetry requirement by granting a LEC a suspension or modification of any section 251(b)(5) reciprocal compensation obligation and the state fails to require symmetric rates, we will invoke our authority under sections 201 and 332 of the Act to ensure

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tions."). "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'" *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. As the Supreme Court has confirmed, this grant of authority necessarily includes section 251(f). *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385 (holding that the Commission has "jurisdiction to promulgate rules . . . regarding rural exemptions"); *see also id.* at 378 n.6 ("[T]he question in theses cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

that all carriers exchanging traffic with that LEC pay the same rate for terminating all traffic.

290. Second, if a state grants any suspension or modification that is more than 1 year in duration, we require the state to take a fresh look to determine whether such suspension/modification continues to satisfy the statutory test in light of possible changes in circumstances. To this end, 90 days before the 1 year anniversary of the grant of the suspension or modification, the LEC must file a petition demonstrating that the suspension or modification continues to satisfy the statutory criteria. In the intervening time, for example, a state may have rebalanced rates, the LEC may have increased its end-user charges, or other relevant changes may have occurred. Those actions may have obviated the need for the suspension or modification or, at a minimum, could result in the need for changes to the terms and duration of the suspension or modification. In such a review, the LEC continues to have the burden of demonstrating that the section 251(f)(2) criteria remain satisfied. We conclude that states should act upon such a fresh look within the 180 days for new petitions set forth in section 251(f)(2).[709]

d. Existing Agreements

291. Below we discuss the effect of our intercarrier compensation reforms on certain types of existing agreements.

292. *Interconnection agreements.* With respect to interconnection agreements, we do not disturb the processes established by section 252 of the Act. As discussed above, the intercarrier compensation reforms we adopt

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[709] 47 U.S.C. § 251(f)(2) ("The State commission shall act upon any petition filed under this paragraph within 180 days after receiving such petition.").

will necessitate that states implement our new reciprocal compensation methodology. We expect that incumbent LECs and competing carriers will implement the reciprocal compensation changes as directed by section 252 of the Act.[761] We make clear that our actions today constitute a change in law, and we recognize that interconnection agreements may contain change of law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.[762] Verizon raises a concern regarding the impact on contracts in "evergreen" status, which Verizon describes as "contracts that have reached the end of their terms but remain in effect pending entry into new contracts."[763] Given that the compre-

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[761] *See* 47 U.S.C. § 252.

[762] *See Triennial Review Order*, 18 FCC Rcd at 17404, para. 700. Although section 252(a)(1) and section 252(b)(1) refer to requests that are made to incumbent LECs, we have interpreted that in the interconnection agreement context to mean that either the incumbent or the competitive LEC may make such a request, consistent with the parties' duty to negotiate in good faith pursuant to section 251(c)(1). *See Triennial Review Order*, 18 FCC Rcd at 17405, para. 703 n.2087; *see also* 47 U.S.C. §§ 251(c)(1), 252(a)(1), (b)(1). We believe that this adequately addresses concerns about existing interconnection agreements that do not include express change of law provisions.

[763] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 5-6 (urging that any new intercarrier compensation regime displace such contracts). By the same token, we decline to insulate existing interconnection agreements from the section 252 processes to the extent that some commenters propose that they remain in effect. *See, e.g.*, Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 04-36, 06-122, 05-195, CC Docket Nos. 01-92, 96-45, 99-68, Attach. at 13 (filed Oct. 7, 2008) (proposing that the Commission "order that those prior arrangements should at least presumptively

hensive reforms today are necessary to eliminate arbitrage and reduce disputes, we believe it is appropriate for carriers to take a "fresh look" at their interconnection agreements in "evergreen" status, including agreements that lack a change-of-law provision, and follow the section 252 process of negotiation and arbitration. We also note that, pursuant to section 251(a)(1), carriers remain free to negotiate alternative arrangements.[764]

293. *Commercial arrangements.* As discussed above, the intercarrier compensation reforms will require carriers to make certain changes to their tariffs relating to carrier-to-carrier charges, and potentially also SLCs. We do not, however, abrogate existing contracts or otherwise allow for a "fresh look" in light of our reforms.[765] As the Commission has recognized, for example, early termination provisions can be mutually beneficial by giving providers greater assurance of cost recovery, and giving customers (whether wholesale or end-users) dis-

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remain in force after the implementation of a new, unified . . . rate regime").

[764] 47 U.S.C. § 251(a)(1).

[765] Several commenters request that the Commission give them a fresh look at existing contracts. *See, e.g.*, Letter from Richard R. Cameron and Teresa D. Baer, Counsel for Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 08-152; CC Docket Nos. 01-92, 99-68, 96-45 at 2 (filed Sept. 18, 2008) (asking that the Commission "provide an 18-month window within which carriers can reconfigure their interconnection facilities without incurring reconfiguration charges or early termination liabilities under existing transport contracts"); Ad Hoc *ICC FNPRM* Comments at 22-24 (arguing that customers should be allowed to opt out of existing contracts); Earthlink *ICC FNPRM* Reply at 7 (arguing that end users should have the opportunity to negotiate different terms and, if renegotiation is not possible, be permitted to terminate existing contracts without liability).

counted and stable prices over the relevant term.[766] Indeed, allowing for a fresh look could result in a windfall for customers that entered long-term arrangements, in exchange for lower prices, as compared to other customers that avoided early termination fees by electing shorter contract periods at higher prices.[767] Rather than adopt a rule that these commercial arrangements must be reopened, we will leave such issues to any change-of law provisions in these commercial arrangements, or to commercial negotiations among the parties.[768]

2. Revenue Recovery Opportunities

294. In the preceding sections of this order, we adopt fundamental changes to the existing intercarrier compensation regimes. These reforms are designed to unify

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[766] *See, e.g., Triennial Review Order*, 18 FCC Rcd at 17400, 17402-03, paras. 692, 697-99; *see also, e.g.*, AT&T *ICC FNPRM* Reply at 17-19 (arguing against giving end users a fresh look at existing contracts). To the extent that there is evidence that particular termination penalties are inappropriate, the Commission can resolve such a matter through an enforcement proceeding. *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 698.

[767] *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

[768] This situation is thus different than cases where the Commission found that certain contract provisions might adversely affect competition or where end-user customers would be denied the benefits of new Commission policy absent a fresh look opportunity. *See, e.g., Local Competition First Report and Order*, 11 FCC Rcd at 16044, para. 1094; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7350, para. 21 (1993) (allowing a fresh look at agreements in "situations where excessive termination liabilities would affect competition for a significant period of time"); *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5907, para. 151 (1991) (giving customers of AT&T 90 days to terminate their contracts without penalty to let them "tak[e] advantage of 800 number portability when it arrives").

and simplify these mechanisms, consistent with the framework Congress adopted in the 1996 Act. This new approach will result in overall reductions in interstate and intrastate intercarrier compensation rates.[769] In this section, we address the extent to which revenue reductions from carrier-to-carrier charges may be replaced through end-user charges and new universal service support. In prior intercarrier compensation reforms, the Commission largely replaced reductions in intercarrier compensation revenues through a combination of increased end-user charges and new universal service funding.[770] Our actions here carefully balance the need to ensure reasonable revenue recovery by carriers against the potential adverse impact on consumers of increased end-user charges, and the pressure placed on the universal service program to the extent that new subsidies are made available.

295. As an initial matter, we increase the caps on interstate SLCs, and we permit incumbent LECs to increase their SLCs up to the new caps to recover lost interstate and intrastate intercarrier compensation revenues. We also enlist the aid of the Separations Joint Board to evaluate the need for further increases in interstate end-user charges to recover any net loss in interstate and intra-state intercarrier compensation revenues, and to evaluate the conditions under which carriers may seek additional universal service funding. To limit the increase in the total universal service fund, we establish certain preconditions that carriers must satisfy before they can receive additional universal service funding to compensate for lost intercarrier compensation revenues.

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[769] *See supra* paras. 186-268.

[770] *See supra* paras. 159-185.

a. End-User Charges

296. In this section, we consider whether revenue reductions from reformed carrier-to-carrier charges should be replaced to any extent by increases in end-user charges, as the Commission has done in some prior intercarrier compensation reform proceedings.[771] The Commission has acknowledged that "[t]he concept that users of the local telephone network should be responsible for the costs they actually cause is sound from a public policy perspective and rings of fundamental fairness," and also helps ensure "that ratepayers will be able to make rational choices in their use of telephone service."[772] Importantly, however, the Commission also has maintained "safeguards that ensure that the rates consumers pay . . . remain well within a zone of reasonableness."[773] To permit carriers to recover at least part of their lost intercarrier compensation revenues, we raise the caps on interstate SLCs as described below, which we find to be within the "zone of reasonableness" and which should not have a significant adverse effect on telephone penetration. We also enlist the help of the Separations Joint Board to consider the need, if any, for further increases

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[771] *See, e.g., First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682; *Access Charge Reform Order*, 12 FCC Rcd 15982; *CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613.

[772] *First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 686, para. 7.

[773] *CALLS Order*, 15 FCC Rcd at 12976, para. 33; *see also, e.g., 1983 Access Charge Order*, 93 FCC 2d at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act").

in end-user charges and certain other revenue recovery issues.

297. The record reveals a wide variety of proposals for modifying interstate end-user charges in response to reductions in intercarrier compensation rates. The majority of these proposals advocate increasing the caps on the interstate SLCs. The interstate SLC is a flat-rated charge that recovers the interstate portion of local loop costs from an end user. Under our current rules governing incumbent LECs, SLCs are subject to a cap that varies based upon whether the line is: (a) a primary residential or single-line business line; (b) a non-primary residential line; or (c) a multi-line business or Centrex line.[774] Some parties propose specific increases in SLC caps to offset a portion of the revenues lost through mandated reductions in intercarrier compensation—including both reductions in interstate and intrastate revenues.[775] Other parties contend that most or all of a carrier's replacement of lost intercarrier compensation revenues should come

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[774] For price cap and rate-of-return carriers, the current SLC cap for residential and single-line business lines is $6.50, 47 C.F.R. §§ 69.104(n)(1)(ii)(C), 69.152(d)(1)(ii)(D), and the current SLC cap for multi-line business and Centrex lines is $9.20, 47 C.F.R. §§ 69.104(o)(1)(i); 69.152(k)(1)(i). Price cap carriers currently also have a SLC cap of $7.00 for non-primary residential lines. 47 C.F.R. § 69.152(e)(1)(i).

[775] *See, e.g.*, ICF *ICC FNPRM* Comments, App. C at C-7; NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7; Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach at 2-3 (filed Sept. 19, 2008); Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 6-7; Letter from Mary L. Henze, Executive Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket Nos. 05-337, 06-112, 99-68, 07-135, Attach. at 2 (filed Oct. 9, 2008).

from increased SLCs.[776] On the other hand, some consumer groups assert that no increase in SLC caps is warranted in response to reductions in intercarrier compensation rates.[777]

(i) Current Availability of End-User Charges for Revenue Recovery

298. As an initial matter, we permit incumbent LECs to increase their SLCs up to new caps to recover reductions in interstate intercarrier compensation revenues. In particular, we increase the SLC cap for residential and single-line business lines from $6.50 to $8.00, the non-primary residential line SLC cap from $7.00 to $8.50, and the multi-line business SLC cap from $9.20 to $11.50. We believe that these modest increases in the SLC caps continue to "ensure that the rates consumers pay for the SLC remain well within a zone of reasonableness."[778]

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[776] *See, e.g.*, Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 5 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Federal Regulatory Affairs, T-Mobile USA, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 8 (filed Oct. 3, 2008); Cox *ICC FNPRM* Comments at 5-6; Eschelon *ICC FNPRM* Comments at 12.

[777] *See* Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01 92, Attach. 2 at 22 (filed Sept. 19, 2008); Letter from David C. Bergmann, Assistant Consumer's Counsel Chair, NASUCA Telecommunications Committee, to Marlene H. Dortch, Secretary, FCC, WC Dockets Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Dockets Nos. 02-6, 01 92, 00-256, 99-68, 96-262, 96-45, 80-286 at 10 (filed Sept. 30, 2008); Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

[778] *CALLS Order*, 15 FCC Rcd at 12976, para. 33. We note that section 54.403 of the Commission's rules provides for Tier 1 lifeline sup-

Moreover, we believe that these SLC cap increases also address commenters' concerns about the need for some end-user recovery in light of lost intercarrier compensation revenues. Although some commenters argue for more substantial increases in the SLC caps, we note that there is evidence that incumbent LECs charge rates below even the existing caps in a number of instances. For example, the primary residential and single-line business SLC cap is $6.50, but the national average SLC for those lines is $5.93 based on recent Commission data.[779] Similarly, the non-primary residential line SLC cap is $7.00, but the national average SLC for those lines is $5.81.[780] Further, the multi-line business and Centrex line SLC cap is $9.20, but the national average SLC for those lines is $6.30—nearly $3.00 below the cap.[781] We therefore find it reasonable in the first instance to raise the interstate SLC cap and to allow carriers whose current SLCs are below the new caps to increase those SLCs to recover revenues lost from interstate and intrastate access charge reductions.[782]

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port to cover the tariffed SLCs established by rate-of-return and price cap carriers pursuant to sections 69.104 and 69.152 of the Commission's rules. 47 C.F.R. § 54.403.

[779] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1 (providing national weighted average SLCs for price cap carriers and all LECs in the NECA pool as of June 30, 2008).

[780] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1.

[781] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1

[782] Should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, the difference between the charges it sets and the maximum charges it is allowed to set may not be recovered through increased SLCs, nor may such carriers seek to obtain supplemental universal service support, as described in Part V.C.2, based on that difference.

299. To the extent that an incumbent LEC increases its SLCs to recover reductions in its interstate intercarrier compensation revenues and any of its SLCs are still below the relevant caps, we allow those carriers to raise their SLCs further, up to the caps, to recover any net loss in intrastate intercarrier compensation revenues, at least on an interim basis.[783] As a prerequisite for incumbent LECs to increase their SLCs in this manner, we require that the LEC's state retail rates and any intrastate SLC be set at the maximum level permitted under state regulations.[784] This will ensure that revenues from interstate end-user charges will not be used to recover intrastate revenue requirements until the carrier has fully availed itself of all available intrastate revenue opportunities under existing law. We also mandate that any increase in interstate SLC revenues that are intended to recover lost intrastate intercarrier compensation revenues be used by the state in ratemaking to reduce costs or revenue requirements to be recovered in the intrastate jurisdiction.[785]

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[783] As discussed below, we are referring to the Joint Board, among other things, the question of whether, and to what extent, net reductions in intrastate intercarrier compensation revenues should be offset by revenues from interstate end-user charges. *See infra* paras. 303-310.

[784] To the extent that a carrier's state retail rates have been deregulated, that carrier may not increase its SLCs to recover any net loss in intrastate intercarrier compensation revenues.

[785] *Cf. Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20486-87, para. 106 (1999) (*Universal Service Ninth Report and Order*) (specifying that "hold-harmless" universal service support "should continue to operate through the jurisdictional separations process to reduce book costs to be recovered in the intrastate jurisdiction.").

300. We find that we have authority to allow recovery of intrastate revenue requirements in this manner. For one, the legacy separations regime does not preclude this action. The Commission historically has provided federal funds to cover at least a portion of costs assigned to the intrastate jurisdiction.[786] Although those decisions relied on the Commission's universal service authority pursuant to section 254, we find that we have authority under section 251(g) to allow recovery of intrastate revenue requirements through interstate SLC rates. Section 251(g) empowers the Commission to subject traffic previously encompassed by section 251(g) to the reciprocal compensation regime of section 251(b)(5), including providing for an orderly transition. Allowing incumbent LECs the option to recover certain lost intrastate intercarrier compensation revenues through increases in the interstate SLC, subject to the new caps, furthers such a transition. In particular, this option helps mitigate any need incumbent LECs might have to seek increases in state rates due to decreases in intrastate intercarrier compensation revenues during the initial stages of the transition, pending the Separations Joint Board referral and subsequent Commission action. We also acknowledge that interstate SLC charges are governed by sections 201 and 202 of the Act, and that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking."[787] In the

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[786] *See, e.g., Universal Service Ninth Report and Order*, 14 FCC Rcd 20432 (providing high-cost universal service support for intrastate costs).

[787] *Access Charge Reform Second Order*, 12 FCC Rcd at 16619-20, para. 44 (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)).

past, the Commission has, in fact, adopted regulatory approaches that deviated from cost-based ratemaking.[788] We find such an approach warranted here to help mitigate regulatory burdens during the transition, as described above.

301. In sum, we adopt increased SLC caps to allow incumbent LECs to recover some or all of their net loss in intercarrier compensation revenues resulting from rate reductions pursuant to this order. In particular, to recover those lost revenues, we permit incumbent LECs to increase each of their SLCs up to the new caps.

302. With respect to non-incumbent LECs, we note that most interstate rates of such providers are not subject to *ex ante* regulation by the Commission. Thus, we allow those carriers to recover any net loss in intercarrier compensation revenues in any lawful manner.[789]

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[788] *See, e.g.*, *LEC Price Cap Order*, 5 FCC Rcd 6786 (adopting price cap regulation, under which rates are not tied directly to cost); *Pricing Flexibility Order*, 14 FCC Rcd 14221, 14307, para. 168 (once price cap carriers are granted pricing flexibility, they lose the option of a low end adjustment, which would permit incumbent LECs earning rates of return less than 10.25% in a given year to increase their price cap indices to a level that would enable them to earn 10.25%.); *MCI Telecomms. Corp. v. U S WEST Commc'ns, Inc.*, File Nos. E-97-08, E-97-20 through 24, Memorandum Opinion and Order, 15 FCC Rcd 9328, 9334, para. 14 (2000) (finding that incumbent LECs' non-cost-based PICC did not violate section 201(b) given the Commission's prior establishment of a safe harbor).

[789] *Cf. Telephone Number Portability*, CC Docket No. 95-116, Third Report and Order, 13 FCC Rcd 11701, 11725-26, 11773-80, paras. 39, 135-49 (1998) (carriers other than incumbent LECs permitted to recover such costs in any lawful manner).

(ii) Joint Board Referral of Possible Changes to End-User Charges

303. We enlist the aid of the Separations Joint Board to evaluate the need for any additional increases in interstate end-user rates for carriers to recover any net loss in interstate and/or intrastate intercarrier compensation revenues as a result of the reform measures we adopt today. There are a range of widely divergent proposals in the record regarding the need for additional changes to the SLC caps adopted above as part of comprehensive intercarrier compensation reform. We believe that the information and analysis developed by the Separations Joint Board will be extremely valuable in evaluating these issues.

304. Our decision to seek input from the Separations Joint Board is consistent with section 410 of the Act. Section 410(c) of the Act requires the Commission to refer to the Separations Joint Board any changes to the separations rules being considered through a rulemaking proceeding. Although no changes to the separations rules are at issue here, section 410(c) also authorizes the Commission to refer matters "relating to common carrier communications of joint Federal-State concern to a Federal-State Joint Board."[750] We believe that recommendations from a Joint Board regarding these issues are important to striking the right balance among the various policy goals at stake, relating to traffic that historically has been regulated, in part, by both federal and state jurisdictions. Moreover, the issue of using revenues from interstate end-user charges to recover intrastate revenue requirements is sufficiently related to the underlying separations requirements themselves that we believe the

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[750] 47 U.S.C. § 410(c).

Separations Joint Board possesses highly relevant expertise to provide recommendations on these issues.[701]

305. As described in greater detail below, we refer to the Separations Joint Board certain specific issues regarding possible increases in interstate end-user charges: (i) whether SLC caps should be increased by a fixed amount to recover any net loss in intercarrier compensation revenues; (ii) whether a "flexible" SLC cap should be used in conjunction with an overall benchmark or threshold; or (iii) some combination of those options.

306. *Quantifying Any Increase in End-User Charges.* We refer to the Separations Joint Board several possible approaches for establishing any additional permissible increases in interstate end-user charges, to the extent that any are warranted. First, the Separations Joint Board could directly recommend particular further increases in the SLC caps. Parties here have proposed various levels of SLC cap increases, and different ways to distribute those increases across the different SLC caps. For example, the ICF proposal would result in all SLC

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[701] The Commission has referred non-separations issues to the Separations Joint Board previously. *See, e.g., MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules*, CC Docket Nos. 78-72, 80-286, Further Notice of Proposed Rulemaking, 49 Fed. Reg. 18318, 18318, para. 1 (1984) (referring to a Separations Joint Board issues including: (1) the subscriber line charge for residential and single-line business customers; (2) the transition mechanism for implementing subscriber line charges for these customers; (3) an exemption from the subscriber line charge or other assistance for low income households; and (4) additional assistance for small telephone companies.); *MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules*, CC Docket Nos. 78-72, 80-286, Recommended Decision, 49 Fed. Reg. 48325, 48327, para. 9 n.20 (1984) (noting that "[s]ince these issues do not involve the allocation of costs between the jurisdictions, preparation of a Joint Board recommendation is not mandatory.").

caps being increased to $10.00 by the end of a transition period.[782] Under the Missoula Plan's initial proposal, SLC cap increases vary for the three "tracks" or categories of carriers defined in the plan.[783] ITTA proposes a $2.25 increase in each SLC cap by the end of a transition period, subject to a benchmark consisting of SLCs, retail rates, and certain other charges.[784] Other parties, such as CTIA, contend that recovery of lost intercarrier compensation revenues by incumbent LECs should come solely from end-user charges.[785] In contrast, Free Press, NASUCA, and Ad Hoc propose that SLC caps not be increased at all.[786]

307. Second, the Separations Joint Board could recommend a "flexible" SLC cap that would vary depending upon a carrier's other end-user rates and an overall benchmark or threshold. For example, under a recent Verizon proposal, the 'default' SLC caps all would increase to $10.00 by the end of a transition period.[787]

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[782] ICF *ICC FNPRM* Comments, App. C at C 7.

[783] NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7.

[784] ITTA Sept. 19, 2008 *Ex Parte* Letter, Attach. at 2-3.

[785] CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 10. *See also, e.g.*, Letter from Norina Moy, Director, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92 at 2 (filed Aug. 7, 2008).

[786] Letter from Ben Scott, Policy Director, Free Press, Washington Office, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. 2 at 22 (filed Sept. 19, 2008); NASUCA Sept. 30, 2008 *Ex Parte* Letter at 10; Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

[787] Verizon Sept. 12, 2008 *Ex Parte* Letter at 6-7.

However, to the extent that a carrier's relevant end-user rates still are below a proposed benchmark, that carrier's SLC cap would increase as much as needed to reach the benchmark.[798] Thus, the Separations Joint Board could determine a particular benchmark or threshold and allow the SLC cap to vary for each carrier, depending upon how much "headroom" that carrier has under the benchmark, in light of the carrier's other rates. To the extent that the Separations Joint Board recommends this approach, it should specify which carrier rates should be included in the relevant benchmark or threshold.

308. Third, the Separations Joint Board could recommend some combination of the first and second options.

309. In making recommendations on these issues, the Separations Joint Board will consider the extent to which any recommended increases in interstate end-user charges should be used to offset lost intrastate intercarrier compensation, to the extent that decreases in interstate intercarrier compensation revenues already have been recovered. Most comprehensive reform proposals in the record assume that SLC cap increases will be used to offset at least some intrastate revenues.[799] Logically, however, another alternative is for any increases in the SLC caps to be used only to recover reductions in interstate intercarrier compensation revenues, and to leave it to each state to address lost intrastate intercarrier compensation revenues as appropriate under state law.

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[798] Verizon Sept. 12, 2008 *Ex Parte* Letter.

[799] To the extent that interstate end-user charges are used to offset any lost intrastate intercarrier compensation revenues, we mandate that the states take account of those revenues in their state ratemaking by reducing the intrastate costs or revenue requirement to be recovered through intrastate rates.

310. *Timing.* We direct the Separations Joint Board to issue its recommended decision not later than one year from the effective date of this order. In light of that timetable, we limit the Separations Joint Board to consideration of specific issues we refer in this order.

b. Universal Service Support

(i) Policy Approach

311. We recognize that the actions we take to reform intercarrier compensation will result in reduced revenues for many carriers. As discussed above, carriers have the opportunity to replace certain of those lost revenues through end-user charges.[800] We also acknowledge that, in the past, the Commission has sometimes provided new universal service support to replace reductions in intercarrier compensation revenues.[801] As the Fifth Circuit has recognized, however, "[b]ecause universal service is funded by a general pool subsidized by all telecommunications providers—and thus indirectly by customers—excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market."[802] Thus, excessive universal service subsidization could, perversely, cause undesirable increases in consumers' bills.

312. We note that many companies—in particular price cap carriers—consistently are paying dividends and

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[800] In this order, we do not decide the maximum amount that incumbent LECs ultimately may charge customers in the form of interstate end-user charges. As discussed above, that will depend upon further Commission action based on recommendations from the Joint Board.

[801] *See, e.g.*, *CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613; *see also MAG* Second *FNPRM*, 19 FCC Rcd 4122.

[802] *Alenco*, 201 F.3d at 620.

are using the same supported network to provide both regulated services and non-regulated services. Throughout the course of our comprehensive reform proceedings, commenters have identified this as a concern to be weighed carefully when evaluating the need for universal service support. For example, following the 2005 intercarrier compensation Further Notice, CTIA contended that some rural incumbent LECs already "are overcompensated by universal service support" based on evidence that their "stocks generate returns, measured by market-to-book ratios, far in excess of, and exhibit significantly lower risk premiums than, the supposedly more secure RBOCs."[803] Commenters continue to express concern that existing universal service subsidies too often lead simply to "'high overhead, sumptuous earnings, [and] rich dividends.'"[804] For example, recent news reports indicate that CenturyTel and Embarq still "remain highly profitable—operating margins for both are 27 percent" notwithstanding any competition they face.[805] Parties have argued that there continues to be evidence that "[i]nvestors place a higher value on RLEC earnings than on other ILEC earnings. In today's market, the larger ILECs, which do not generate much of their revenues from federal subsidies, are valued much less highly per dollar of profit."[806] While there are "various factors

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[803] CTIA *ICC FNPRM* Comments at 37 citing Western Wireless Reply, CC Docket No. 96-45, Attach. at 2-5 (filed Dec. 14, 2004) (attaching Economics and Technology, Inc., *Reforming Universal Service Funding for Rural ILECs: An Idea Whose Time Has Come*).

[804] Thomas W. Hazlett, *"Universal Service Telephone Subsidies: What Does $7 Billion Buy?* (*Universal Service Telephone Subsidies*) at 33, *attached to* Core *Missoula Phantom Traffic* Comments, Tab B (quotation omitted).

[805] *A Fair Copper*, FINANCIAL TIMES, Oct. 28, 2008, at 16.

[806] *Universal Service Telephone Subsidies* at 34.

in play" this suggests that "[m]illions of dollars in extra wealth end up in the hands of private investors" by "transferring income from telephone users to phone company stockholders."[807] Indeed, commenters note that "some carriers owned by co-ops pay their members annual dividends that exceed their members' local phone charges."[808] In light of these concerns and the mandates of section 254, we agree with commenters that it is not appropriate to require all universal service contributors to pay into the fund so that these carriers can continue to pay dividends.[809]

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[807] *Universal Service Telephone Subsidies* at 34, 70. *See also* Julie Tanner, General Counsel, Chinook Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10, Attach. 1 at 7 (filed Feb. 22, 2008) (arguing that incumbent LECs receiving universal service support "send a comfortable return on investment to investors (and rural cooperative members) with no accountability"); NTCH, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10 at 8 (filed Feb. 22, 2008) ("The object of the [universal service] subsidy is not to prop up high cost legacy companies and technologies or assure their profitability, nor to add to the profits of wireless carriers.").

[808] *Universal Service Telephone Subsidies* at 70.

[809] *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 68 ("Even if excessive support does not lead to unaffordable increases in rates for non-subsidized subscribers, requiring those customers to pay more than is necessary in order to excessively subsidize rates for other [services] (or worse yet, to finance high dividend payments to owners of rural ILECs) is not consistent with maintaining just and reasonable rates."); Time Warner Telecom *Missoula Phantom Traffic* Comments at 10 (noting that "RBOCs are already realizing substantial profits from [network] investments, easily compensating for any loss in access payments that they may face" and that "a high [universal service] contribution level may approach the point at which the USF charges imposed upon end-users actually threaten the goal of universal service").

313. Thus, rather than guaranteeing revenue neutrality, as some commenters propose,[810] we take steps here to ensure that any new universal service subsidies are targeted carefully to situations where they are most crucially needed. In particular, far from the regulated monopolies of years past, significant marketplace developments have resulted in additional revenue opportunities for carriers. As NASUCA observes, "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets."[811] "By way of illustration," NASUCA points out that "using their common local loop platform, carriers are now generating billions of dollars in digital subscriber line ("DSL") revenues that they did not generate five or ten years ago."[812] Indeed,

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[810] *See, e.g.*, CenturyTel Sept. 19, 2008 *Ex Parte* Letter, Attach. at 5 (arguing that revenue neutrality should be a fundamental goal of comprehensive intercarrier compensation reform); Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 04-36, 05-337, 06-122, Attach. at 3 (filed Sept. 16, 2008) (arguing that, if the Commission does not adopt the Missoula Plan, it should establish a mechanism for "rural RoR ILECs that allows for full recovery of the revenues lost as a result of the change in intrastate access rates and structure, on a revenue neutral basis."). *See also* Rural Alliance *ICC FNPRM* Comments at 21 (arguing that decreases in intercarrier compensation rate levels should be offset from the USF or another revenue replacement mechanism).

[811] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[812] Comments of the National Association of State Utility Consumer Advocates to Refresh the Record, CC Docket Nos. 96-45, 02-6, 01-92, 00-256, 96-262, 99-68, 80-256, WC Docket Nos. 05-337, 07-135, 06-122, 05-195, 03-109, 02-60 at 6 (filed July 7, 2008) (NASUCA July 7, 2008 Supp. Comments). *See also id.* at 10 ("Adding insult to injury, there is no consideration in the Missoula Plan of the additional revenues that ILECs gain from serving new broadband lines which are outside of the current ICC system. In other words, ILECs are losing

Time Warner Telecom has pointed to evidence that, for some carriers, "revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services."[813] Thus, Free Press observes that "the unregulated revenue streams of rate-of-return and price cap Local Exchange Carriers serving in high-cost areas" are the "500 pound gorilla in the room," and it contends that "these revenues" should be "considered in the discussions of 'need' for the purposes of universal service."[814] We agree that such "new and growing source[s] of revenues should mitigate the impact of inter-carrier compensation reform for rural and other carriers."[815]

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lines and MOU as consumers drop traditional landlines and add broadband lines to access the Internet. However, the revenue gains from broadband line additions are totally out of the picture as far as the Missoula Plan is concerned.").

[813] Time Warner Telecom *Missoula Phantom Traffic* Comments at 10 ("According to AT&T, the revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services. As AT&T stated in its Annual Report, '[w]e have found that when customers add broadband to a basic package, they are 40 percent less likely to switch to another provider, and average revenue per customer jumps nearly 120 percent.' It would make little sense for the ratepayers to subsidize the ILECs' already profitable business decisions.").

[814] Free Press Oct. 13, 2008 *Ex Parte* Letter at 6. *See also id.* at 6-7 ("While we'd like the Commission to consider a carrier's entire revenue stream before allowing increased USF support to offset lost access revenues" to the extent that there is such support it "should be confined to rate-of-return carriers only.").

[815] NASUCA July 7, 2008 Supp. Comments at 6. Indeed, there is some indication that carriers may be earning excessive returns even with respect to their regulated services. *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 66-67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25% rate of return on its regulated interstate switched access services, including

314. We are concerned that universal service support be targeted to those companies whose reduced intercarrier compensation revenues truly are needed to continue providing quality service at affordable rates, and that it should not simply enable the company to pay bigger dividends to shareholders or pad a company's bottom line. Therefore, for price cap carriers, we adopt the proposal of various commenters to consider all a company's costs and revenues—both regulated and non-regulated—before providing new universal service support.[816] Thus, price cap incumbent LEC seeking universal service funding to replace lost intercarrier compensation revenues must make such a showing to the Commission when petitioning for such support. We recognize that rate-of-return carriers present a special situation, because under our rules they must be provided an opportunity to earn the rate of return established by our orders.[817] As a result, we do not impose a similar condition before rate-of-return carriers can recover universal service support.

32.12% for 1997-98, 30.26% for 1999-2000; 35.29% for 2001-02; and 15.01% for 2003-04).

[816] *See, e.g.*, Letter from Mary C. Albert, Assistant General Counsel, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 05-337, 04-36 at 1 (filed Oct. 2, 2008); NASUCA July 7, 2008 Supp. Comments at 32-34; Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1-2 (filed Oct. 7, 2008).

[817] *See, e.g.*, Free Press Oct. 13, 2008 *Ex Parte* Letter at 6-7 (noting that, to the extent that there is universal service support to address any net loss in intercarrier compensation revenues, it "should be confined to rate-of-return carriers only."). *But see, e.g.*, GCI *Missoula Phantom Traffic* Comments at 66-67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25% rate of return on its regulated interstate switched access services).

315. We also agree with proposals that carriers fully avail themselves of existing opportunities for end-user recovery before collecting new universal service subsidies.[818] To the extent that regulators have determined that rates at a particular level are reasonable, we find it appropriate for carriers to charge those rates in the first instance, rather than pricing below those levels in order to foist recovery of the additional revenues on universal service contributors. Consequently, as additional preconditions for receiving new universal service support, any carrier—whether price cap or rate-of-return—must show that its federal SLC, state SLC (if any), and state retail local service rates are at the maximum levels permitted under existing applicable law.[819]

316. In conjunction, we conclude that the conditions we adopt as prerequisites for obtaining new universal service support adequately target that support to carriers with a genuine need without unduly burdening con-

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[818] *See, e.g.*, Letter from Donna Epps, Vice President--Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1-2 (filed Oct. 2, 2008); Letter from Robert W. Quinn, Jr., Senior Vice President—Federal Regulatory, AT&T, to Kevin Martin, Chairman, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 07-135, 05-337 at 5-7 (filed July 17, 2008); Letter from Anthony M. Alessi, Senior Counsel, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 3-5 (filed May 23, 2008); Cox *ICC FNPRM* Comments at 12-13.

[819] Although we do not adopt a particular revenue benchmark here, as some commenters propose, the Joint Board may well recommend such an approach. Thus, depending upon the Joint Board's proposal, and the Commission's subsequent action, maximum federal SLCs and/or state retail local rates might be determined, in part, by such a benchmark.

sumers with excessive new universal service contribution burdens.[820]

(ii) Legal Authority

317. Consistent with our mandate to "ensure that universal service is available at rates that are just, reasonable, and affordable," we establish a new supplement to IAS and ICLS universal service funding mechanism.[821] As we did recently in two other Commission orders that reformed interstate switched access charges, we include here additional universal service funding to keep retail rates affordable while ensuring that maintaining affordable rates does not unduly threaten the financial viability of rate-regulated incumbent LECs.[822] Our decision to establish a new funding mechanism is also consistent with our general authority under section 4(i) of the Act because it furthers our universal service objectives.[823]

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[820] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

[821] 47 U.S.C. § 254(i) (requiring that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."); *see also* 47 U.S.C. §254(b)(1) (stating that "[q]uality services should be available at just, reasonable, and affordable rates").

[822] *See, e.g., CALLS Order*, 15 FCC Rcd at 12971, para. 24; *MAG Order*, 16 FCC Rcd at 19669-70, para. 132.

[823] Section 4(i) provides that the Commission may "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). Prior to the enactment of section 254 (as part of the 1996 Act), sections 1 and 4(i) provided authority for the Commission's adoption of a universal service fund. *See Rural Telephone Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988). *See also New England Telephone and Telegraph Co. v. FCC*, 826

Mindful of our obligation to ensure that these new subsidies are made available only where essential, however we make new universal service subsidies available subject to specific conditions that will target the support to only those carriers whose circumstances merit it.

(iii) Access to Universal Service Support

318. As discussed below, we limit access to universal service support to incumbent LECs that meet certain preconditions. As an initial matter, we find that limiting such support to incumbent LECs is consistent with their position in the marketplace and the resulting regulatory constraints on their pricing behavior. In a series of orders in the Competitive Carrier proceeding, the Commission distinguished two kinds of carriers—those with individual market power (dominant carriers) and those without market power (non-dominant carriers).[824] The Com-

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F.2d 1101, 1107 (D.C. Cir. 1987) (describing section 4(i) as a "wide-ranging source of authority"), *cert. denied*, 490 U.S. 1039 (1989).

[824] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (*Competitive Carrier First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed. Reg. 17308 (1982); Second Report and Order, 91 FCC 2d 59 (1982) (*Competitive Carrier Second Report and Order*); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28292 (1983); Third Report and Order, 48 Fed. Reg. 46791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (*Competitive Carrier Fourth Report and Order*), *vacated, AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), Fifth Report and Order, 98 FCC 2d 1191 (1984) (*Competitive Carrier Fifth Report and Order*); Sixth Report and Order, 99 FCC 2d 1020 (1985), *vacated, MCI Telecomms. Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985) (*Competitive Carrier Sixth Report and Order*), *aff'd, MCI v. AT&T*, 512 U.S. 218 (1994) (collectively, the *Competitive Carrier* proceeding); *see* 47 C.F.R. § 61.3(q), (y).

mission found it appropriate to continue to subject dominant carriers to full regulation under Title II of the Communications Act.[825] Incumbent LECs are dominant carriers in their provision of switched access services and, as a result, are subject to rate regulation.[826] This rate regulation comes in two forms—regulation of intercarrier charges and regulation of end user charges. The Commission regulates interstate end-user charges of incumbent LECs, while the states generally regulate those carriers' intrastate end-user rates. Unlike incumbent LECs, competitive carriers (e.g., such as competitive LECs, CMRS providers, and non-dominant IXCs) lack market power and are considered non-dominant. As a result, their end-user charges are not subject to comparable rate regulation by the Commission and the states.[827]

319. Because incumbent LECs, as a result of their classification as dominant carriers, have had their end-user charges regulated (both in terms of rate levels and rate structures), they have less flexibility than other car-

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[825] *Competitive Carrier First Report and Order*, 85 FCC 2d at 10-11, para. 26.

[826] *See Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112; CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440, 16484, para. 90 (2007).

[827] For instance, the Commission has declined to regulate the SLCs of competitive LECs. *See Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10870 n.8 (2002) (subsequent history omitted); *see also CLEC Access Charge Order*, 16 FCC Rcd at 9955, para. 81 (stating that competitive LECs competing with CALLS incumbent LECs are free to build into their end-user rates a component equivalent to the incumbent LEC's SLC).

riers to recover decreased intercarrier revenues through end-user charges. As a result, they are less likely to be able to recover reductions in intercarrier compensation revenues resulting from the actions we take today. Accordingly, we conclude that access to universal service support should be limited to incumbent LECs that meet the necessary preconditions. For this reason, we disagree with parties that advocate making funding available to all carriers, both incumbent and competitive[928] or to all carriers that currently receive access charge revenues.[929] As discussed above, competitive carrier end-user

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[928] *See, e.g.*, T-Mobile Oct. 3, 2008 *Ex Parte* Letter at 9 & n.14 (arguing that "any ICC replacement mechanism be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality."). Sprint argues that a fund that compensates only incumbent LECs (and not competitive LECs, wireless carriers, and IXCs) for lost access revenues is "blatantly anti-competitive." Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket No. 04-36 at 4 (filed Oct. 1, 2008). Many CMRS carriers maintain that any replacement mechanism must be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality. *See, e.g.*, Leap *ICC FNPRM* Reply at 18; Allied National *ICC FNPRM* Comments at 10; CTIA *ICC FNPRM* Comments at 37; SouthernLINC *ICC FNPRM* Reply at 9; RCA *ICC FNPRM* Comments at 4; US Cellular *ICC FNPRM* Comments at 4; T-Mobile *ICC FNPRM* Comments at 26; Dobson and American *ICC FNPRM* Comments at 10.

[929] *See, e.g.*, ICF *ICC FNPRM* Comments at 32-33 (stating that any funding should be temporary and limited to those that lose access revenue because of intercarrier compensation reform); USTA *ICC FNPRM* Comments at 40 (arguing that funding should not compensate wireless carriers and that it should not be portable); CCAP *ICC FNPRM* Reply at 14 (stating that funding "should not be portable to competitive eligible telecommunications carriers."); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket

charges are not subject to rate regulation, and those carriers have the opportunity to recover lost access revenue through any legally permissible means.[839] We also reject an approach that would limit funding to rural rate-of-

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Nos. 01 92, 96 45, Attach. at 7 (filed Oct. 12, 2008) (asserting that funding should compensate only LECs that have lost revenues because of intercarrier compensation reform); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, Docket Nos. 01-92, 04-36, 96-45, 05-337, Attach. at 9 (filed Oct. 3, 2008) (arguing that the Commission should "limit duplicative networks" by prohibiting wireless carriers and other carriers that do not receive access compensation from benefiting from the fund); Letter from Alex J. Harris, Vice President—Regulatory, Frontier, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 16, 18 (filed May 11, 2005) (proposing that the funding be confined to incumbent LECs in rural study areas but available to all carriers that lost access revenues in non-rural study areas); *see also* Letter from Brad E. Mutschelknaus, Counsel to XO Communications, Kelley Drye & Warren LLP, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 06-122, Attach. at 4 (filed Oct. 3, 2008) (contending that revenue replacement funding should either be "competitively neutral" or limited to only rate of-return carriers).

[839] Some competitive LECs claim that, in practice, they have little opportunity to recover their costs because the incumbent LEC, whose prices are regulated, effectively sets a ceiling on the prices they charge. *See, e.g.*, COMPTEL *Missoula Phantom Traffic* Comments at 7. Although we acknowledge that, in a homogeneous goods market with a single price, such an argument might be plausible, we do not find such assumptions apply in modern telecommunications markets. In particular, with modern telecommunications technology, carriers are offering an expanding number of new services and marketing them through a variety of bundled service offerings. As a result, telecommunications services are becoming much more of a differentiated product, and competitors have greater opportunity to offer niche services. In light of these developments, we find unpersuasive arguments that competitors are effectively price regulated and thus do not have an opportunity to recover lost access revenues.

return carriers.[831] Incumbent LECs subject to price cap regulation also are subject to regulatory constraints on end-user charges, and we therefore decline to categorically deny universal service funding to particular types of incumbent LECs.[832]

320. Consistent with the policy approach discussed above, we further find it necessary to establish certain requirements that an incumbent LEC must satisfy to receive the new universal service subsidies. Before seeking universal service funding, incumbent LECs must first demonstrate that their end-user charges are at the maximum allowable rate levels. Thus, incumbent LECs must show that they are charging the maximum interstate SLCs permitted under applicable law, and they must make the same showing with respect to any intrastate SLCs. In addition, incumbent LECs must demonstrate that their retail local rates are at the maximum allowable amount based on applicable state regulation. Incumbent LECs operating in states where retail rates are deregulated are not entitled to the new universal service funding adopted here. In this case, these incumbent LECs will be similarly situated to competitive carriers, because without regulation, they have the opportunity to

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[831] *See, e.g.*, NCTA *ICC FNPRM* Comments at 11 (arguing that funding should be limited to "non Tier 1 rural carrier[s]"); NTCA *ICC FNPRM* Comments at 56 (asserting that funding "should be targeted at rural ILECs exclusively"); Comments of the Rural Alliance, CC Docket No. 01-92 at 4 (filed Jun. 27, 2008) (stating that the fund should only compensate rural rate-of-return carriers that lose access revenues).

[832] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

recover lost access revenues due to intercarrier compensation reform through increased end-user charges.

321. As discussed below, there are additional requirements to qualify for universal funding that vary depending on whether a carrier is subject to price cap or rate-of-return regulation. In either case, the incumbent LEC bears the burden of demonstrating that it is entitled to such funding based on the following criteria.

322. *Rate-of-Return Incumbent LECs.* For incumbent LECs subject to rate-of-return regulation, a carrier may qualify for universal service funding if it can demonstrate that, it will not have a reasonable opportunity to earn its authorized rate of return as a result of its net loss of revenues caused by the changes in intercarrier compensation rates resulting from this order, even after having increased its interstate SLC, state SLC (if any), and state retail local rates to the maximum permitted by applicable law.

323. *Price Cap Incumbent LECs.* For incumbent LECs subject to price cap regulation, a carrier may qualify for universal service funding if it can demonstrate that, as a result of reduced and reformed intercarrier charges, and after accounting for increased end-user charges, it is still unable to earn a "normal profit." In the *Local Competition First Report and Order*, the Commission discussed the concept of normal profit and defined it as the "total revenue required to cover all the costs of a firm, including its opportunity costs."[833]

324. As described above, many companies—in particular, price cap carriers—consistently are paying dividends and are using the same supported network to pro-

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[833] *Local Competition First Report and Order*, 11 FCC Rcd at 15854, para. 699.

vide both regulated services and non-regulated services.[834] We do not find it appropriate to require all universal service contributors to pay into the fund to provide for "'high overhead, sumptuous earnings, [and] rich dividends'" on the part of these carriers.[835] Indeed, as discussed above,[836] "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets"[837] in addition to other nonregulated services that use "their common local loop platform."[838] Therefore, in determining whether this criterion is met, the Commission will evaluate the total costs and total revenues of the company as a whole, including those from both regulated and non-regulated sources.[839] While this is a more stringent showing than that required of rate-of-return carriers, we find such differences warranted by the different rate regulation frameworks. In light of our reforms, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of-return regulation.[840]

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[834] *See supra* para. 312.

[835] *Universal Service Telephone Subsidies* at 33.

[836] *See supra* para. 313.

[837] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[838] NASUCA July 7, 2008 *Ex Parte* Letter at 6.

[839] The non-regulated costs and revenues to be included in this calculation are those associated with non-regulated activities involving the common or joint use of assets or resources in the provision of both regulated and non-regulated products and services.

[840] Pursuant to section 61.41(d) of the Commission's rules, once a carrier is subject to price cap regulation, it may not "withdraw from such regulation." 47 C.F.R. § 61.41(d); *see also* 47 C.F.R. § 61.41(b), (c) (requiring conversion from rate-of-return to price cap regulation under certain circumstances). Under section 1.3 of the Commission's rules, however, "any provision of the Commission's rules may be

325. We recognize that the conditions by which we would make universal service funding available may not ensure that all carriers recover all reduced intercarrier compensation revenues that result from the reforms we adopt here. We reject the assertion by some carriers that any revenue replacement mechanism adopted by the Commission in the context of intercarrier compensation reform must ensure absolute revenue neutrality.[841] We agree with commenters who maintain that the Commission has no legal obligation to ensure that carriers recover every dollar in access revenues lost as a result of

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waived by the Commission . . . if good cause therefore is shown." 47 C.F.R. § 1.3. As interpreted by the courts, this requires that a petitioner demonstrate that "special circumstances warrant a deviation from the general rule and that such a deviation will serve the public interest." *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164 (D.C. Cir. 1990) (citing *WAIT Radio v. FCC*, 418 F.2d 1153, 1158 (D.C. Cir. 1969)). In other circumstances in the past, the Commission has found good cause to waiver section 61.41(d) and other related provisions of the Commission's rules to enable operations subject to price cap regulation to convert to rate-of-return regulation. *See, e.g., ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules and Application for Transfer of Control*, CCB/CPD No. 99-1, Memorandum Opinion and Order, 14 FCC Rcd. 14191 (1999); *CenturyTel of Northwest Arkansas, LLC et al., Joint Petition for Waiver of Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Petition for Waiver of Sections 61.41(c) and 69.3(g)(2) of the Commission's Rules*, CC Docket No. 96-45, Memorandum Opinion and Order, 15 FCC Rcd 25437 (Acc. Pol. Div. 2000); *ALLTEL Service Corporation, Petition for Waiver of Section 61.41 of the Commission's Rules*, Order, 8 FCC Rcd 7054 (Com. Car. Bur. 1993) (granting waiver of sections 61.41(c), (d) of the Commission's rules). Likewise, as noted above, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of return regulation.

[841] *See supra* para. 313.

reform, absent a showing of a taking.[842] We conclude that certain increased end-user charges and narrowly targeted supplemental IAS or ICLS universal service support will provide a reasonable opportunity to recover revenues lost as a result of our intercarrier compensation reform, and to earn a reasonable profit. Such recovery, however, is not automatic and whether a particular carrier is entitled to any revenue recovery will be considered on a case-by-case basis based on the criteria outlined here.

D. Measures to Ensure Proper Billing

1. Introduction

326. As explained in Part V.A., the current disparity of rates under existing intercarrier compensation mechanisms presents service providers[843] with the opportunity and the incentive to misidentify or otherwise conceal the source of traffic to avoid or reduce payments to other service providers. In this Part, we amend our rules to help ensure the ability of service providers to receive the appropriate compensation for traffic terminated on their

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[842] *See, e.g.*, Ad Hoc *ICC FNPRM* Reply at 10-11 (arguing that the Commission has no legal obligation to allow revenue neutrality); CTIA *ICC FNPRM* Comments at 46; Nextel *ICC FNPRM* Comments at 20; T-Mobile *ICC FNPRM* Comments at 13 (intercarrier compensation was not intended to guarantee an ILEC revenue stream or preserve low local rates for a given industry segment, doing so would perpetuate inefficiencies); NASUCA *ICC FNPRM* Reply at 34-38 (arguing that the Commission is not required to provide for revenue neutrality and that revenue neutrality deviates from the Commission's past policy).

[843] We use the term "service providers" in this section to refer both to carriers that provide telecommunications services and to providers of services that originate calls on IP networks and terminate them on circuit switched networks.

networks.[844] More importantly, we believe that the comprehensive compensation reforms we adopt today should significantly reduce service providers' incentives to mislabel traffic or otherwise to try to avoid their financial obligations.[845] Nonetheless, we balance a desire to facilitate resolution of billing disputes with a reluctance to regulate in areas where industry resolution has, in many cases, proven effective. We find that the requirements we adopt here will facilitate the transfer of information to terminating service providers, and improve their ability to identify providers from whom they receive traffic, without imposing burdensome costs. In the event that traffic does not contain the information required by our rules, or the provider delivering the traffic does not otherwise provide the required call information, for example by providing an industry-standard billing record, to the provider receiving it, we allow the terminating service provider to charge its highest terminating rate to the service provider delivering the traffic. To the extent that a provider acting simply as an intermediate provider (such as a transit provider) becomes subject to a charge under this provision, that intermediate provider can charge the rate it was charged to the provider that deliv-

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[844] Parties frequently use the term "phantom traffic" in describing this problem. We will not use that term in the regulations we adopt here because there is no consensus as to how it should be defined, nor is such a definition necessary for us to address the underlying issues faced by service providers in billing for traffic they receive.

[845] Similarly, we believe that the transition to a uniform intercarrier compensation rate based on the additional costs methodology described above also will address the access stimulation concerns that have recently been raised. *See supra* para. 185. In the unlikely event that service providers persist in these activities, however, we note that the Commission has an open proceeding in which appropriate responses to such actions may be considered. *See generally Access Stimulation NPRM*, 22 FCC Rcd 17989.

ered the improperly labeled traffic to it. This will ensure that providers are paid for terminating traffic in those instances, and gives financial incentives for upstream providers in the call path to ensure that the traffic includes proper information in the first instance.

2. Background

327. Problems related to traffic arriving for termination with insufficient identification information arise from the technical systems and processes used to create, transfer, and gather intercarrier compensation billing information. To bill for termination of traffic, a terminating service provider must be able to identify the appropriate upstream service provider, and the location of the caller (or a proxy for the caller's location) in order to determine jurisdiction, which is necessary to determine the appropriate charge under existing intercarrier compensation rules.[846] Calls frequently traverse several networks to connect the calling and called parties. When the originating and terminating networks are not directly connected, as is the case when calls are delivered via tandem transit service, complications with transmitting and receiving billing information related to a call can arise.[847] Terminating service providers that are not directly connected to originating service providers receive information about calls sent to their networks for termination

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[846] This order initiates a process of unifying terminating intercarrier compensation rates, thereby eliminating the rate distinctions between local and long distance calls. Although knowing the origination point of a call remains important, especially during the period of transition to a unified terminating rate, the origination point is less significant for the purpose of determining intercarrier compensation due.

[847] *See, e.g.*, Letter from Patrick J. Donovan, Counsel for PacWest Telecomm, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3-4 (filed Oct. 14, 2005).

from two sources: Signaling System 7 (SS7) signaling streams[848] and industry standard billing records,[849] which

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[848] SS7 is an out-of-band signaling system that is separate from, but runs parallel to, the public switched telephone network (PSTN) and is used to set up call paths between calling and called parties. The following steps typically occur when SS7 sets up a call path for a wireline LEC to wireline LEC call originating and terminating on the PSTN. When a wireline LEC customer dials a call destined for an end user served by a different wireline LEC, the calling party's LEC determines, based on the dialed digits, that it cannot terminate the call. The SS7 call signaling system then begins the process of identifying a path that the call will take to reach the called party's network. SS7 identifies each service provider in the call path and provides each with the called party's telephone number and other information related to the call, including message type and nature of connection indicators, forward call indicators, calling party's category, and user service information if that information was correctly populated and not altered during the signaling process. *See* Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Sept. 13, 2005) (Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter). SS7 was designed to facilitate call routing and was not designed to provide billing information to terminating carriers. *See* Verizon, *Verizon's Proposed Regulatory Action to Address Phantom Traffic* at 5-7 (Verizon Phantom Traffic White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 20, 2005). Technical content and format of SS7 signaling is governed by industry standards rather than by Commission rules, although Commission rules require carriers using SS7 to transmit calling party number (CPN) to subsequent carriers on interstate calls where it is technically feasibly to do so. 47 C.F.R. § 64.1601.

[849] Industry standard billing records are the other common source of information that terminating service providers not directly connected to originating service providers receive about calls sent to their networks for termination. Billing records are typically created by a tandem switch that receives a call for delivery to a terminating network via tandem transit service. Tandem switches create billing records by combining CPN or Charge Number (CN) information from the SS7 signaling stream with information identifying the

typically are provided by the intermediate service provider connecting the terminating provider to the originating provider.[850]

328. One significant source of billing problems is traffic routed through an intermediate provider that does not include calling party number (CPN) or other information identifying the calling party.[851] In addition, commenters

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originating service provider to provide terminating service providers with information necessary for billing. *See* Verizon Phantom Traffic White Paper at 5-7. The tandem switch creating the billing record identifies service providers from whom it receives traffic using the trunk group number (TGN) of the trunk on which a call arrives. *See* Verizon Phantom Traffic White Paper at 4; *see also* Letter from Glenn T. Reynolds, Vice President—Federal Regulatory, BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92, Attach. at 5 (filed Jan. 12, 2006) (BellSouth Jan. 12, 2006 *Ex Parte* Letter). The tandem switch translates the TGN into one of two codes identifying the originating the service provider: Carrier Identification Code (CIC) if the originating service provider is an IXC, or Operating Company Number (OCN) for non-IXC calls. The appropriate CIC or OCN is then added, by the tandem switch, if it is equipped to record such information, to the billing record for the call, which is then forwarded to the terminating service provider. *See* Verizon Phantom Traffic White Paper at 5-7; *see also* Verizon *ICC FNPRM* Reply at 16. Service providers delivering billing records typically use the Exchange Message Interface (EMI) format created and maintained by the Alliance for Telecommunications Industry Solutions Ordering and Billing Forum (ATIS/OBF), an industry standards setting group. *See* ATIS Exchange Message Interface 22 Revision 2, ATIS Document number 0406000-02200 (July 2005).

[850] *See* Verizon Phantom Traffic White Paper at 5-7.

[851] The Commission recognized that the ability of service providers to identify the provider to bill appropriate intercarrier compensation payments depends, in part, on billing records generated by interme diate service providers. Thus, the Commission sought comment on whether current rules and industry standards create billing records that are sufficiently detailed to permit determinations of the appro-

describe several examples of other situations where traffic arrives for termination with insufficient information to identify the originating service provider.[852] Another source of disputes occurs when terminating service providers find differences when attempting to reconcile SS7 data they record and billing records they receive.[853] Such a reconciliation process will likely be inexact, because SS7 streams were not designed to provide billing information.[854] Similarly, at least one commenter asserts that "problems arise" when terminating service providers "second guess tandem traffic reports and generate their own billing statements for carriers with whom they are

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priate compensation due. *See Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4743, para. 133.

[852] For example, when a call bound for a number that has been ported to a different service provider is delivered without the responsible service provider performing a local number portability (LNP) query, the call may be delivered to the wrong end office and then may be rerouted to a tandem switch for delivery to the correct end office. *See* Verizon Phantom Traffic White Paper at 18-19. According to Verizon, neither the end office that reroutes the call nor the tandem switch receiving the rerouted call are able to route the call over an access trunk; the call must be sent over a local interconnection trunk. *See id.* In this scenario, the terminating carrier may have difficulty billing the appropriate charges to the IXC that sent the call.

[853] *See* Letter from Stephen T. Perkins, General Counsel, Cavalier Telephone, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 29, 2005). *See also* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 10 (filed Oct. 21, 2005).

[854] *See* Letter from Donna Epps, Vice President—Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 5 (filed Aug. 1, 2005); Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2.

indirectly interconnected."[855] In addition to unidentifiable traffic caused by unintended network routing circumstances, as described above, several commenters allege that they receive traffic in which the billing information intentionally has been altered or stripped before the call reaches the terminating service provider.[856] Indeed, numerous parties have described experiencing problems of the sort described above.[857] Several proposals suggesting how the Commission should address this problem have been filed in the record in this proceeding in recent years.[858] Recently, the United States Telecom Associa-

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[855] Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 3.

[856] *See, e.g.*, Balhoff and Rowe *ICC FNPRM* Reply at 10; California Small LECs *ICC FNPRM* Comments at 9; ITCI *ICC FNPRM* Reply at 7; Montana Independent Telecommunications Systems (MITS) et al. *ICC FNPRM* Comments at 14, 20; MITS et al. *ICC FNPRM* Reply at 23-24, 33; NECA *ICC FNPRM* Comments at 16; Rural Alliance *ICC FNPRM* Comments at 108; SureWest *ICC FNPRM* Comments at 7; TDS *ICC FNPRM* Comments at 10; BellSouth Jan. 11, 2006 *Ex Parte* Letter at 6.

[857] *See, e.g.*, Letter from Glenn T. Reynolds, Vice President, Policy, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 12, 2008) (USTA Feb. 12, 2008 Proposal). *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, NECA Petition for Interim Order (filed Jan. 22, 2008) (NECA Petition).

[858] *See, e.g.*, NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2; Letter from Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 6, 2006) (Missoula Plan Supporters Nov. 6 *Ex Parte* Letter or Missoula Plan Call Signaling Proposal); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 4, 2006); Letter from Jeffrey S. Lanning, Associate General Counsel, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006) (MCC/USTA Proposal); Letter from Karen Brinkmann, Attorney for the MidSize Carrier Coalition, to Marlene H. Dortch, Sec-

tion (USTelecom) filed a proposal that appears to enjoy the broadest industry support of any filed to date.[859] For reasons detailed below, we agree that traffic that lacks sufficient information to enable proper billing of intercarrier compensation charges is a problem. Consequently, we take steps to address the problem and help ensure proper functioning of the intercarrier compensation system.[860]

3. Discussion

329. We amend our rules as described below to facilitate the transfer of necessary information to terminating service providers, particularly in cases where traffic is

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retary, FCC, CC Docket No. 01-92 (filed Mar. 31, 2006) (supporting MCC/USTA Proposal).

[859] *See* USTA Feb. 12, 2008 Proposal; *see also* Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 24, 2008); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2, filed Sept. 19, 2008); Letter from Eric Einhorn, Vice president, Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 et al. (filed Sept. 24, 2008); Comments of Windstream, CC Docket Nos. 99-68, 01-92, 96-45, WC Docket Nos. 08-152, 07-135, 04-36, 06-122, 05-337 at 16 (filed Aug. 21, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Aug. 6, 2008); Letter from Henry Hultquist, Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 17, 2008).

[860] The rules we adopt herein reflect the Commission's determinations regarding how to address call signaling problems as they relate to unidentified and unbillable traffic. Therefore, we disagree with commenters requesting that we adopt alternative proposals such as the NECA petition or the Missoula Plan Call Signaling Proposal. *See, e.g.*, Letter from Robert F. Aldrich, Counsel to the American Public Communications Council, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92 (filed Oct. 21, 2008).

delivered through indirect interconnection arrangements. These new requirements will assist in determining the appropriate service provider to bill for any call. We note that these new requirements generally reflect standard industry practice, as recommended by several commenters.[861] We also amend our rules to establish payment obligations for service providers that send traffic that lacks the information required by our amended call signaling rules to intermediate or terminating service providers or that does not otherwise provide the required call information to the recipient. Incorporating these practices into our rules will facilitate resolution of billing disputes, will provide incentives to help prevent manipulation or deletion of information from signaling streams, and will provide incentives for service providers to ensure that traffic traversing their networks is properly labeled and identifiable, in compliance with the rules we adopt in this order.[862]

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[861] *See, e.g.*, Letter from Paul Garnett, Director, Regulatory Policy, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Jan. 3, 2006); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006).

[862] The rules we amend in this order were adopted in a 1995 order addressing Caller ID services. *See Rules and Policies Regarding Calling Number Identification Service—Caller ID*, CC Docket No. 91-281, Memorandum Opinion and Order on Reconsideration, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 11700, 11728, para. 79 (1995) (*Caller ID Order*). In the *Caller ID Order*, the Commission found, inter alia, that the CPN based services to which the rules adopted apply are "jurisdictionally mixed" and the Commission therefore preempted an inconsistent state statute. *Id.* at 11722-23, paras. 62, 85. For these same reasons, to the extent the amendments we make to our call signaling rules in this order conflict with any current or future state statutes, those statutes are preempted. *See id.* at 11728-34, paras. 78-95.

a. Signaling Information

330. We agree with the USTelecom Feb. 12, 2008 Proposal concerning the importance of call signaling obligations.[853] CPN is a critical component of call signaling information. When CPN is populated in the SS7 stream by an originating service provider and passed, unaltered, along a call path to a terminating service provider, the terminating provider can use the CPN information to help determine the applicable intercarrier compensation.

331. We agree with commenters[854] that assert that the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call is to require providers to populate, and to prohibit them from stripping or altering, CPN information in the SS7 call signaling stream.[855] In an environment where numerous service providers may be involved in the completion of a call, this SS7 signaling information must be passed, unaltered, from one to the next in a call

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[853] *See* USTA Feb. 12, 2008 Proposal.

[854] *See, e.g.*, USTA Feb. 12, 2008 Proposal; NECA Petition.

[855] Because we agree that requiring population of CPN is the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call, we disagree with proposals to exclude certain types of traffic from this requirement. *See, e.g.*, Letter from Jim Kohlenberger, Executive Director, The VON Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket 04-36 at 6 (filed Oct. 28, 2008). We note that parties are free to contract with third parties to ensure that these requirements are met. *Cf., e.g.*, *LNP Order*, 22 FCC Rcd 19531 (holding that, where interconnected VoIP providers rely on other carriers for access to numbers, both parties must take the steps needed to comply with the number porting obligations established in that order); *Interconnected VoIP 911 Order*, 20 FCC Rcd 10245 (finding that interconnected VoIP providers might elect to comply with their 911 obligations in party by relying on services provided by third parties).

path until it reaches the terminating service provider. We therefore modify our rules to prohibit stripping or altering information in the SS7 call signaling stream. We do not, however, make any changes to the designation of particular fields as mandatory or optional, nor do we otherwise intend to change industry standards that govern the population of the SS7 signaling stream.[864]

332. The record also makes clear that we must expand the scope of our existing rule regarding passing CPN,[865] which currently applies only to service providers using SS7 and only to interstate traffic. We therefore extend these requirements to all traffic originating or terminating on the PSTN, including jurisdictionally intrastate traffic.[866] We also amend our rules to require service providers using MF signaling to pass CPN information, or the charge number (CN) if it differs from the CPN, in the Multi Frequency Automatic Number

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[864] We take a cautious approach in considering any new or revised signaling requirements. SS7 was designed to facilitate call setup and routing, and action we take here is not intended to interfere with the ability of calls to reach their intended recipient. As Verizon Wireless explains, certain SS7 fields are considered mandatory, while others (including CPN, CN, and JIP) are considered optional. *See* Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2. The distinction is significant, because a call will not be completed if a mandatory field has not been populated. *See* Letter from Thomas Goode, Associate General Counsel, ATIS, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. (filed Feb. 10, 2006). Although CPN is considered optional in the industry standard, our rules, before and after amendment pursuant to this order, require service providers to pass CPN in specified circumstances. *See* 47 C.F.R. § 64.1601.

[865] *See* 47 C.F.R. § 64.1601.

[866] *See supra* note 862.

Identification (MF ANI) field.[869] This rule change will ensure that information identifying the calling party is included in call signaling information for all calls.

333. In addition, we agree with commenters who suggest that our call signaling rules should address CN as well as CPN.[870] Verizon states that, in accordance with industry practice, the CN parameter is not populated in the SS7 stream when it is the same as CPN, but that when the CN parameter is populated, CN is included in billing records in place of CPN.[871] We therefore clarify that populating a CN field with information other than the charge number to be billed for the call, consistent with industry standards, falls within this prohibition. This clarification is not intended to disrupt standard industry practice with regard to using CN in the signaling stream and in billing records. But, we also clarify that the prohibition on altering or stripping signaling information applies to CN as well as CPN. The prohibition on altering or stripping SS7, MF ANI, or CN signaling information obligates intermediate service providers to pass, unaltered, whatever signaling information they receive.

334. The call signaling rules we adopt in this order will help ensure that signaling information is passed completely and accurately to terminating service providers. These rules are not intended to affect existing

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[869] *See* Missoula Plan at 56; Letter from Brad E. Mutschelknaus, Counsel for XO, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 11-12 (filed Feb. 14, 2006).

[870] *See, e.g.*, NECA Petition; Letter from Cheryl A. Tritt, Counsel for T-Mobile USA, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 6 (filed Feb. 2, 2006); Verizon Phantom Traffic White Paper at 8-10.

[871] *See* Verizon Phantom Traffic White Paper at 8.

agreements between service providers regarding how to "jurisdictionalize" traffic when traditional call identifying parameters are missing, as long as such agreements are not inconsistent with the rules adopted in this order.

335. We find that some very limited exceptions to these new rules are needed. We agree with Verizon, for example, that a limited exception is needed in situations where industry standards permit, or even require, some alteration in signaling information by an intermediate service provider.[872] As noted above, we do not intend to change standard industry practice with respect to the content of the signaling stream. Service providers that follow standard industry practice in this way will not be considered in violation of the prohibition on altering signaling information. We also note that the exemptions from our existing call signaling requirements described in section 64.1601(d) remain necessary for their limited purposes, and will continue to apply.[873]

b. Financial Responsibilities

336. We also impose financial responsibilities that will work in step with our amended signaling rules to give service providers financial incentives to ensure that they, and the providers whose traffic they carry, comply with the signaling obligations. We find that these requirements will significantly reduce any existing incentives to avoid compliance by substantially eliminating any financial benefits of noncompliance.

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[872] *See* Verizon Phantom Traffic White Paper at 9-10. For example, Verizon states that on a call to a party that has forwarded its number, the called party's service provider will replace the caller's CN with the called party's CN before sending the call to the forward location.

[873] 47 C.F.R. § 64.1601(d).

337. We agree with commenters who propose that we permit service providers that terminate traffic lacking sufficient information to bill the service provider that delivered the traffic to the terminating provider.[874] In particular, we require that a service provider, e.g., transit provider, delivering traffic that lacks any of the signaling information required by our rules as amended herein, or that does not otherwise provide the required call information, for example by providing an industry standard billing record, to the recipient, must pay the terminating service provider's highest termination rate in effect at the time the traffic is delivered to the terminating service provider.[875] By making intermediate service providers

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[874] *See, e.g.*, EPG Proposal at 2 ("All messages that are not properly labeled would be billed at the highest prevailing intercarrier compensation rate to the interconnecting carrier delivering the traffic."); ARIC Plan at 55; CenturyTel *ICC FNRPM* Comments at 6; Hickory *ICC FNPRM* Comments at 2; JSI *ICC FNPRM* Comments at 4-6; Colorado Telecom Ass'n et al. *ICC FNPRM* Reply at 13, TDS Telecom *ICC FNPRM* Reply 14, JSI *Missoula Phantom Traffic* Comments at 4-6; RICA *Missoula Phantom Traffic* Comments at 2-3; TexalTel *Missoula Phantom Traffic* Comments at 7-8; Cavalier *Missoula Phantom Traffic* Comments at 2-3; PAPUC *Missoula Phantom Traffic* Reply at 8.

[875] We agree with commenters who note that intermediate service providers that provide, to subsequent service providers in a call path, information sufficient to identify the provider that delivered the traffic to the intermediate provider should not be responsible for terminating intercarrier payments for that traffic. *See, e.g.*, Letter from Susanne A. Guyer, Senior Vice President—Federal Regulatory Affairs, Verizon, to Chairman Kevin Martin et al., FCC, CC Docket Nos. 96-45, 01-92 at 2 (filed Oct. 28, 2008); Letter from Mark D. Schneider, Counsel, Neutral Tandem, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008); Letter from Tamar E. Finn, Counsel, Zayo Group, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 2 (filed Oct. 28, 2008).

financially responsible in these circumstances, we ensure that service providers are compensated for terminating traffic.

338. We also permit those intermediate service providers, in turn, to pass along the termination charges to the provider that delivered the applicable traffic to them, in addition to any otherwise-applicable charge for their services. We agree with commenters that the providers delivering traffic are in a better position than the terminating service provider "to know which carriers are routing improperly or incompletely identified traffic"[876] and to recover the termination charges from them. Moreover, by permitting intermediate service providers to pass along those charges on top of their otherwise-applicable rates, we create disincentives for service providers who might otherwise originate, or act as a "pass through" for mislabeled or unidentifiable traffic.

339. We are unpersuaded by the objections to imposing such financial obligations on intermediate service providers.[877] For example, one objection is based on the assumption that transit providers will be the only intermediate service providers subject to such liability, and will be unable to pass along those charges.[878] The finan-

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[876] ARIC Plan at 55.

[877] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 7, 2007); Letter from Charles W. McKee, Director—Government Affairs, Federal Regulatory, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Apr. 20, 2007) (Sprint Nextel April 20, 2007 *Ex Parte* Letter); Letter from Charon Phillips, Director—Government Affairs, Federal Regulatory, Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 13, 2007).

[878] *See, e.g.*, Verizon *Missoula Phantom Traffic* Reply at 5-6.

cial responsibility under this order for traffic that lacks sufficient billing information is not limited to transit service providers, however. Rather, any service provider that passes traffic lacking sufficient billing information becomes responsible for intercarrier payments to the receiving provider. Additionally, we expressly permit service providers subject to this charge to pass it along to the service provider that delivered the applicable traffic to them.

340. Another commenter objects to any proposal that "gives . . . [ILECs] the authority to impose new rates based on their own interpretation of the sufficiency of data received or interpretation of jurisdictional parameters."[879] Under our amended rules, service providers will not be able to impose rates based on their own interpretation of the sufficiency of data received. Instead, our amended rules set the standard for what information must be included and passed.

341. We also disagree with commenters who suggest that imposing liability on intermediate service providers implies that the problem is the result of transiting service providers altering call detail information.[880] The financial obligations we impose on intermediate service providers are triggered by passing traffic that does not comply with the call signaling rules, regardless of whether the traffic was originated or altered by the passing service provider. Accordingly, any service provider, not just a provider who stripped or altered traffic signaling, who is not taking steps to ensure that traffic carried on their network is properly labeled and identifiable could be held responsi-

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[879] *See* Sprint Nextel April 20, 2007 *Ex Parte* Letter at 2.

[880] *See* Missoula Plan Supporters *Missoula Phantom Traffic* Reply at 11-12.

ble for payment by the provider to whom it delivered traffic.

342. In addition to call signaling, the USTelecom Feb. 12, 2008 proposal seeks Commission action related to routing traffic, local number portability queries, and providing incumbent LECs with certain rights with regard to the section 251 and 252 negotiation and arbitration processes.[881] Although a broad cross section of the industry supports the USTelecom Feb. 12, 2008 proposal in its entirety, several commenters objected to the section 251 and 252 negotiation and arbitration provisions.[882] In light of the lack of consensus on some of these issues and the changes to the intercarrier compensation system adopted in this order we are not persuaded that the other specific actions sought in the USTelecom Feb 12, 2008 proposal are necessary at this time.[883]

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[881] *See* USTA Feb. 12, 2008 Proposal.

[882] *See, e.g.*, Letter from Brad Mutschelknaus, Counsel to Broadview Networks et al. to Kevin J. Martin et al., FCC, CC Docket No. 01-92 (filed Oct. 22, 2008); Letter from Henry T. Kelly, Counsel to Peerless Networks to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92 et al. (filed Sept. 16, 2008); Letter from Charles W. McKee, Director—Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 16, 2008); Letter from Thomas Cohen, Edward A. Yorkgitis, Jr., Counsel for NuVox Communications et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 11, 2008); Letter from Daniel L. Brenner, Senior Vice President, Law and Regulatory Policy, NCTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 29, 2008); Letter from Paul Garnett, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 25, 2008).

[883] The USTA Feb 12, 2008 Proposal also sought certain enforcement commitments related to our call signaling rules. In this regard, USTA's proposal did not seek anything beyond the ordinary course of business. As with any of our rules, the Commission is committed

VI. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Universal Service Contributions

343. As we explain above, an assessment methodology based solely on telephone numbers would not require certain business services to equitably contribute to the universal service fund.[884] We, therefore, determine that universal service contributions for business services will be based on connections as opposed to numbers. We seek comment on how best to implement a connection-based mechanism for business services, and whether that mechanism should be based solely on connections or on a combination of Assessable Numbers and connections.

344. We also seek comment on expanding our NRUF data collection to all providers who are required to contribute to the universal service fund based on Assessable Numbers. At present, our NRUF reporting rules require "reporting carriers" to file reports. A "reporting carrier" is defined as "a telecommunications carrier that receives numbering resources from the NANPA, a Pooling Administrator or another telecommunications carrier."[885] "Reporting carriers" file reports regarding six categories of numbers, the descriptions of some of which refer to "telecommunications carriers" or "telecommunications services."[886] We seek comment on whether we should amend our rules to require all providers who as-

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to resolving complaints expeditiously and will not hesitate to initiate enforcement proceedings against rule violators.

[884] *See supra* para. 130.

[885] 47 C.F.R. § 52.12(f)(2).

[886] *E.g.*, 47 C.F.R. § 52.12(e)(i) ("*Administrative numbers* are numbers used by telecommunications carriers . . . ."); *id.* § 52.12(e)(v) ("*Intermediate numbers* are numbers that are made available . . . for the purpose of providing telecommunications service . . . .").

sign numbers or otherwise make numbers available to end users to file NRUF reports. Would such an expansion assist the Commission and the fund administrator with monitoring and enforcing universal service contribution requirements? What modifications would the Commission need to make to its rules to effectuate this kind of policy change?

B. Intercarrier Compensation Further Notice

345. In this Further Notice of Proposed Rulemaking (Further Notice) we seek comment on certain additional issues not resolved in our accompanying order.

346. *Originating Access.* In this order, we conclude that retention of originating access charges would be inconsistent with our new regulatory approach to intercarrier compensation.[887] Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated by the conclusion of the transition to the new regime. We seek comment on issues relating to the transition for the elimination of originating access.

347. *Transit Traffic.* Transiting occurs when two carriers that are not directly interconnected exchange traffic by routing the traffic through an intermediary carrier's network.[888] We request comment on whether the reforms we adopt today necessitate the adoption of any rules or guidelines governing transit service.

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[887] *See supra* para. 229.

[888] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4737-38, para. 120. Typically, the intermediary carrier is an incumbent LEC and the transited traffic is routed from the originating carrier through the incumbent LEC's tandem switch to the terminating carrier. The intermediary (transiting) carrier then charges a fee for use of its facilities. *See id.* We note that carriers have various agreements governing the provision of transit traffic. *See id.*

348. *Universal Service Rules Applicable to Rate-of-Return Carriers.* In this order, we conclude that under certain circumstances, rate-of-return carriers will be able to receive universal service support to recover net reduced revenues from intercarrier compensation as a result of reforms adopted in this order that they do not otherwise recover through SLC increases or other revenue increases. We seek comment on what rule changes are necessary to allow rate-of-return carriers to receive universal service support in this manner.

349. *Parts 51, 54, 61 and 69.* Part 51 of the Commission's rules contain requirements applicable to interconnection, including reciprocal compensation.[889] Part 54 of the Commission's rules describe universal service programs and administration.[890] Part 61 of the Commission's rules prescribes the framework for the initial establishment of and subsequent revisions to tariff publications.[891] Part 69 of the rules governs the Commission's access charge regulations for interstate or foreign access services.[892] We solicit comment on the need to revise the rules set forth in Parts 51, 54, 61 and/or 69, or any other rules, as a result of the reforms we adopt today.

VII. PROCEDURAL MATTERS

A. *Ex Parte* Presentations

350. The rulemaking this Further Notice initiates shall be treated as a "permit-but-disclose" proceeding in accordance with the Commission's ex parte rules.[893] Persons making oral ex parte presentations are reminded

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[889] *See* 47 C.F.R. Part 51.

[890] *See* 47 C.F.R. Part 54.

[891] *See* 47 C.F.R. Part 61.

[892] *See* 47 C.F.R. Part 69.

[893] 47 C.F.R. § 1.200 *et seq.*

that memoranda summarizing the presentations must contain summaries of the substance of the presentations and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and arguments presented generally is required.[894] Other requirements pertaining to oral and written presentations are set forth in section 1.1206(b) of the Commission's rules.[895]

B. Comment Filing Procedures

351. Pursuant to sections 1.415 and 1.419 of the Commission's rules,[896] interested parties may file comments and reply comments regarding the Further Notice on or before the dates indicated on the first page of this document. **All filings related to the intercarrier compensation Further Notice of Proposed Rulemaking should refer to CC Docket No. 01-92. All filings related to the universal service contributions Further Notice of Proposed Rulemaking should refer to WC Docket No. 06-122. All filings related to numbering reporting issues of the universal service contributions Further Notice of Proposed Rulemaking should refer to CC Docket No. 99-200.** Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's e-Rulemaking Portal, or (3) by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 FR 24121 (1998).

352. Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal e-Rule-

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[894] *See* 47 C.F.R. § 1.1206(b)(2).

[895] 47 C.F.R. § 1.1206(b).

[896] 47 C.F.R. §§ 1.415, 1.419.

making Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

353. ECFS filers must transmit one electronic copy of the comments for CC Docket Nos. 01-92, 99-200, or WC Docket No. 06-122, respectively. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

354. Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554.

355. The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

356. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be

sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

357. U.S. Postal Service first-class, Express, and Priority mail should be addressed to 445 12th Street, S.W., Washington D.C. 20554.

358. Parties should send a copy of their filings in CC Docket No. 01-92 to Victoria Goldberg, Pricing Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A266, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

359. Parties should send a copy of their filings in WC Docket No. 06-122 to Jennifer McKee, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

360. Parties should send a copy of their filings in WC Docket No. 99-200 to Marilyn Jones, Competition Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W.,

Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

361. Documents in CC Docket Nos. 01-92, 99-200, and WC Docket No. 06-122 will be available for public inspection and copying during business hours at the FCC Reference Information Center, Portals II, 445 12th Street S.W., Room CY-A257, Washington, D.C. 20554. The documents may also be purchased from BCPI, telephone (202) 488-5300, facsimile (202) 488-5563, TTY (202) 488-5562, e-mail fcc@bcpiweb.com.

C. Initial Regulatory Flexibility Analysis

362. As required by the Regulatory Flexibility Act of 1980,[86] the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the policies and rules addressed in this document. The IRFA is set forth in Appendix E. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice provided on or before the dates indicated on the first page of this Notice.

D. Final Regulatory Flexibility Analysis

363. Pursuant to the Regulatory Flexibility Act (RFA),[88] the Commission has prepared a Final Regulatory Flexibility Analysis (FRFA) for the Report and Order concerning the possible significant economic impact

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[86] *See* 5 U.S.C. § 603.

[88] *See* 5 U.S.C. § 603. The RFA, *see* U.S.C. § 601 *et seq.*, has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) ("CWAAA"). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 ("Small Business Act").

on small entities by the policies and actions considered in the Report and Order.

E. Paperwork Reduction Act

364. This document contains proposed new or modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198,[89] we seek specific comment on how we might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

F. Accessible Formats

365. To request materials in accessible formats for people with disabilities (Braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice) or 202-418-0432 (TTY). Contact the FCC to request reasonable accommodations for filing comments (accessible format documents, sign language interpreters, CART, etc.) by e-mail: FCC504@fcc.gov, phone: 202-418-0530 or TTY: 202-418-0432.

G. Congressional Review Act

366. The Commission will include a copy of this Order on Remand and Report and Order and Further Notice of Proposed Rulemaking in a report to be sent to Congress and the Government Accountability Office pursuant to

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[89] *See* 44 U.S.C. § 3506(c)(4).

the Congressional Review Act. See 5 U.S.C. § 801(a)(1)(A).

VIII. ORDERING CLAUSES

367. Accordingly, IT IS ORDERED that, pursuant to Sections 1-4, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, and 503 of the Communications Act of 1934, as amended, and Sections 601 and 706 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 157 nt, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, 503, and sections 1.1, 1.411-1.429, and 1.1200-1.1216 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.411-1.429, 1.1200-1.1216, the ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING ARE ADOPTED.

368. IT IS FURTHER ORDERED that Parts [___] of the Commission's rules, 47 C.F.R. § [____] are AMENDED as set forth in Appendix A hereto.

369. IT IS FURTHER ORDERED, in light of the opinion of the United States Court of Appeals for the District of Columbia Circuit in *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), we consider our obligations met from the writ of mandamus issued in *In re Core Communications, Inc. on Petition for Writ of Mandamus to the Federal Communications Commission*, D.C. Cir. No. 07-1446 (decided July 8, 2008).

370. IT IS FURTHER ORDERED that this ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING shall become effective 30 days after publication of the text of a summary thereof in the Federal Register, pursuant to 47 C.F.R. §§ 1.4, 1.13, except for the information collections, which require approval by OMB under the PRA and which shall become effective after the

Commission publishes a notice in the Federal Register announcing such approval and the relevant effective date(s).

371. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this REPORT AND ORDER AND ORDER ON REMAND, including the Final Regulatory Flexibility Analyses and Final Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

372. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this FURTHER NOTICE OF PROPOSED RULEMAKING, including the Initial Regulatory Flexibility Analyses and Initial Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch

Secretary

* * * * *

FILED

No. 10-185

AUG 6 - 2010

IN THE

OFFICE OF THE CLERK

Supreme Court of the United States

CORE COMMUNICATIONS, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI
(VOLUME II OF III)

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TABLE OF CONTENTS

Page

Volume I

Appendix A – Court of Appeals Opinion in *Core Communications, Inc.* v. *FCC*, 592 F.3d 139 (D.C. Cir. 2010) 1a

Appendix B – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 15a

Volume II

Appendix B (continued) – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 399a

Volume III

Appendix C – Court of Appeals Opinion in *In re Core Communications, Inc.*, 531 F.3d 849 (D.C. Cir. 2008) 792a

Appendix D – Court of Appeals Opinion in *In re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006) 819a

TABLE OF CONTENTS—Continued

Page

Appendix E – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. May 24, 2005) 847a

Appendix F – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. Nov. 22, 2004) 848a

Appendix G – Federal Communications Commission Order in *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the* ISP Remand Order, 19 F.C.C.R. 20,179 (Oct. 18, 2004) 849a

Appendix H – Court of Appeals Opinion in *WorldCom, Inc.* v. *FCC*, 288 F.3d 429 (D.C. Cir. 2002) 872a

Appendix I – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 F.C.C.R. 9151 (Apr. 27, 2001) 882a

Appendix J – Court of Appeals Opinion in *Bell Atlantic Telephone Cos.* v. *FCC*, 206 F.3d 1 (D.C. Cir. 2000) 1015a

TABLE OF CONTENTS—Continued

Page

Appendix K – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 F.C.C.R. 3689 (Feb. 26, 1999) 1032a

Appendix L – Court of Appeals Order Denying Panel Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010) 1085a

Appendix M – Court of Appeals Order Denying *En Banc* Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010) 1087a

Appendix N – Relevant Statutory Provisions 1089a

FEDERAL COMMUNICATIONS COMMISSION
FCC 08-262

APPENDIX C
ALTERNATIVE PROPOSAL

IN THE MATTER OF

HIGH-COST UNIVERSAL SERVICE SUPPORT
WC DOCKET NO. 05-337

FEDERAL-STATE JOINT BOARD
ON UNIVERSAL SERVICE
CC DOCKET NO. 96-45

LIFELINE AND LINK UP
WC DOCKET NO. 03-109

UNIVERSAL SERVICE CONTRIBUTION METHODOLOGY
WC DOCKET NO. 06-122

IMPLEMENTATION OF THE LOCAL COMPETITION PROVISIONS IN THE TELECOMMUNICATIONS ACT OF 1996
CC DOCKET NO. 96-98

DEVELOPING A UNIFIED INTERCARRIER
COMPENSATION REGIME
CC DOCKET NO. 01-92

INTERCARRIER COMPENSATION
FOR ISP-BOUND TRAFFIC
CC DOCKET NO. 99-68

IP-ENABLED SERVICES
WC DOCKET NO. 04-36

NUMBERING RESOURCE OPTIMIZATION
CC DOCKET NO. 99-200

ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: "Insert Adopted Date"
Released: "Insert Release Date"

Comment Date:	**[XX days after publication in the Federal Register]**
Reply Comment Date:	**[XX days after publication in the Federal Register]**

By the Commission:

TABLE OF CONTENTS

Heading	Paragraph #
I. INTRODUCTION	1
II. REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT	4
A. Background	5
B. Discussion	12
1. Controlling the Growth of the High-Cost Fund	14
2. Conditioning Support on Offering Broadband Internet Access Service	19
a. Definition of Broadband Internet Access Service	24
b. Broadband Internet Access Service Obligations	25
3. Incumbent LECs' Commitment to Offer Broadband	28
4. Reverse Auctions for Study Areas Unserved by Broadband	32
a. Geographic Area	35
b. Reserve Price	36
c. Auctioned Support	38
d. Selecting a Winning Bid	43
e. Bidder Qualifications	48
5. Competitive Eligible Telecommunications Carriers	51
6. Build-Out Milestones and Monitoring, Compliance, and Enforcement	53
III. BROADBAND FOR LIFELINE/LINK UP CUSTOMERS	60
A. Background	61

B. Discussion 67
1. Available Funding 73
2. Eligible Services and Equipment 76
3. Selection Criteria 81
4. Implementation and Reporting Requirements 84
5. Program Oversight 87
IV. REFORM OF UNIVERSAL SERVICE CONTRIBUTIONS 88
A. Background 89
B. Discussion 93
1. Legal Authority 94
2. The New Numbers-Based Assessment Methodology for Residential Services 101
a. Benefits of a Numbers-Based Contribution Methodology 102
b. Assessable Numbers 111
3. Contribution Assessment Methodology for Business Services 126
4. Wireless Prepaid Plans 131
5. Exceptions to Contribution Obligations 136
6. Reporting Requirements and Recordkeeping 142
7. Transition to New Methodology 149
V. REFORM OF INTERCARRIER COMPENSATION 152
A. A Brief History of Intercarrier Compensation 154
1. Intercarrier Compensation Regulation Before the Telecommunications Act of 1996 155

2. Intercarrier Compensation Regulation Since the 1996 Act 164
3. Problems Associated With the Existing Intercarrier Compensation Regimes 173
B. Comprehensive Reform 181
1. Introduction 181
2. A New Approach to Intercarrier Compensation 183
3. Legal Authority 202
a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g) 202
b. Legal Authority for the Transition 225
4. Additional Costs Standard 231
a. Background 232
b. The Importance of Incremental Cost In Regulated Pricing 235
c. The Incremental Cost of Call Termination on Modern Networks 248
d. Reconsideration of Additional Costs Standard 257
C. Implementation 264
1. Direction to the States 265
a. Setting Final Reciprocal Compensation Rates Based on Incremental Cost 266
b. Symmetry 271
c. Modifications and Suspensions under Section 251(f)(2) 277

d. Existing Agreements 286
2. Revenue-Recovery Opportunities 289
a. End-User Charges 291
b. Universal Service Support 306
D. Measures to Ensure Proper Billing 322
1. Introduction 322
2. Background 323
3. Discussion 325
a. Signaling Information 326
b. Financial Responsibilities 332
VI. FURTHER NOTICE OF PROPOSED RULEMAKING 339
A. Universal Service Contributions 339
B. Intercarrier Compensation Further Notice 342
VII. PROCEDURAL MATTERS 347
A. *Ex Parte* Presentations 347
B. Comment Filing Procedures 348
C. Initial Regulatory Flexibility Analysis 359
D. Final Regulatory Flexibility Analysis 360
E. Paperwork Reduction Act 361
F. Accessible Formats 362
G. Congressional Review Act 363
VIII. ORDERING CLAUSES 364

I. INTRODUCTION

1. In enacting the Telecommunications Act of 1996 (1996 Act),[1] Congress sought to introduce competition into local telephone service, which traditionally was provided through regulated monopolies. Recognizing that in introducing such competition, it was threatening the implicit subsidy system that had traditionally supported universal service, it directed the Commission to reform its universal service program to make support explicit and sustainable in the face of developing competition.

2. For the most part, Congress's vision has been realized. Competition in local telephone markets has thrived. At the same time, the communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted. The Internet was only briefly mentioned in the 1996 Act,[2] but now has come into widespread use, with broadband Internet access service increasingly viewed as a necessity. Consistent with this trend, carriers are converting from circuit-switched networks to Internet Protocol (IP)-based networks. These changes have benefited consumers and should be encouraged. Competition has resulted in dramatically lower prices for telephone service, and the introduction of innovative broadband products and services has fundamentally changed the way we communicate, work, and obtain our education, news, and entertainment. At the same time, however, these developments have challenged the outdated regulatory assumptions underlying our universal service and intercarrier compensation regimes, forcing us to reassess our existing approaches.

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act).

[2] *See* 47 U.S.C. § 230; 47 U.S.C. § 157 nt.

We have seen unprecedented growth in the universal service fund, driven in significant part by increased support for competitive eligible telecommunications carriers (ETCs). The growth of competition also has eroded the universal service contribution base as the prices for interstate and international services have dropped. Finally, we have seen numerous competitors exploit arbitrage opportunities created by a patchwork of above-cost intercarrier compensation rates. Although the Commission has attempted to address many of these issues on a case-by-case basis, it has become increasingly clear that piecemeal efforts to respond to these developments are inadequate—only comprehensive reform can address the fundamental challenges that they present.[3]

3. Today we adopt a comprehensive approach to addressing these difficult, but critical issues. First, we spur widespread deployment of broadband by ensuring that carriers receiving universal service high cost support of-

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[3] We thus conclude that there is a compelling need to proceed with comprehensive reform at this time, as we describe below. *See, e.g., infra* Parts II.A, III.A, IV.A, and V.B. Given that we have notice and an extensive record, going back in some cases seven years, we are unpersuaded by commenters proposing that we delay reform to seek further comment, or that we issue a Further Notice of Proposed Rulemaking on questions beyond those raised in Part VI. *See e.g.*, Letter from Ray Baum, Chairman, NARUC Communications Committee, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 80-286, WC Docket Nos. 08-152, 04-32, 06-122, WT Docket No. 05-194 at 2 (filed Oct. 21, 2008) (NARUC Oct. 21, 2008 *Ex Parte* Letter); Letter from Jeffery S. Lanning, Embarq, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 04-36 at 2 (filed Oct. 28, 2008) (Embarq Oct. 28, 2008 *Ex Parte* Letter); Letter from Eric N. Einhorn, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 06-122, 07-135, 08-152 at 1 (filed October 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter).

fer broadband throughout their service areas. Second, we help Lifeline/Link Up customers participate in this new broadband world by creating a pilot program to provide discounted access to broadband services. Third, we broaden and stabilize our universal service contribution base through equitable and non-discriminatory contributions. Fourth, having placed our universal service fund on solid footing, we now take the long-overdue step of moving toward uniform intercarrier compensation rates that provide efficient incentives for the investment in and use of broadband networks. Finally, our approach minimizes disruptions to carriers and safeguards universal service for consumers by adopting sensible transition plans and ensuring that universal service is used to support service in high-cost areas, not carriers' dividends.

II. REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT

4. Today we take a monumental step toward our goal of ensuring that broadband is available to all Americans. We do this by requiring that all recipients of high-cost support offer broadband Internet access service to all customers within their supported areas as a condition of receiving future support. Taking this action will promote the deployment of broadband Internet access service to all areas of the nation, including high-cost, rural, and insular areas where customers may not currently have access to such services. In particular, as a condition of receiving continued high-cost support, we will require all incumbent local exchange carriers (LECs) to commit to offer broadband Internet access service within five years to all customers in study areas where the incumbent LECs receive high-cost support. Incumbent LECs that do not make this commitment will gradually lose their high-cost support, as this support will be awarded via re-

verse auction to an ETC who will meet carrier of last resort obligations and will commit to offering broadband Internet access to all customers in the entire study area within ten years. We also adopt a five year transition plan for existing high-cost support received by competitive ETCs. With these reforms, we take great strides toward ensuring that all Americans, regardless of where they live, will have broadband Internet access service available to them, without increasing the size of the high-cost fund.

A. Background

5. The 1996 Act amended the Communications Act of 1934 (the Act) with respect to the provision of universal service.[4] Congress sought to preserve and advance universal service, while at the same time opening all telecommunications markets to competition.[5] Section 254(b) of the Act directs the Federal-State Joint Board on Universal Service (Joint Board) and the Commission to base policies for the preservation and advancement of universal service on several general principles, plus other principles that the Commission may establish.[6] Among other things, section 254(b) directs that there should be specific, predictable, and sufficient federal and state universal service support mechanisms; quality services should be available at just, reasonable, and affordable rates; and access to advanced telecommunications and information services should be provided in all regions of the nation.[7]

6. The Commission implemented the universal service provisions of the 1996 Act in the 1997 *Universal Ser-*

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[4] 47 U.S.C. § 254 (added by the 1996 Act).

[5] 47 U.S.C. § 254.

[6] *See* 47 U.S.C. § 254(b).

[7] 47 U.S.C. § 254(b)(1), (2), (5).

vice First Report and Order.[8] In considering methods to determine universal service support in rural, insular, and high-cost areas, the Commission examined the use of competitive bidding, and identified several advantages of competitive bidding as a method for allocating high-cost universal service support.[9] First, the Commission found that "a compelling reason to use competitive bidding is its potential as a market-based approach to determining universal service support, if any, for any given area."[10] Second, "by encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured competitive bidding system would be its ability to reduce the amount of support needed for universal service."[11] Despite these advantages, the Commission determined that the record at the time was insufficient to support adoption of a competitive bidding mechanism.[12] Moreover, the Commission found it

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[8] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8780-88, paras. 1-20 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

[9] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[10] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 (agreeing with the Joint Board). The Commission also agreed with the Joint Board that "competitive bidding is consistent with section 254, and comports with the intent of the 1996 Act to rely on market forces and to minimize regulation." *Id.* at 8951, para. 325

[11] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 ("In that regard, the bidding process should also capture the efficiency gains from new technologies or improved productivity, converting them into cost savings for universal service.").

[12] *See Universal Service First Report and Order*, 12 FCC Rcd at 8949-50, paras. 322-23. Only GTE had proposed a detailed competitive bidding plan, which it characterized as an outline rather than a

unlikely that competitive bidding mechanisms would be useful at that time because there likely would be no competition in a significant number of rural, insular, or high-cost areas in the near future.[13] The Commission, therefore, declined to adopt a competitive bidding mechanism at that time, but found that competitive bidding warranted further consideration as a potential mechanism for determining levels of high-cost support in the future.[14]

7. Pursuant to section 254(e) of the Act, an entity must be designated as an eligible telecommunications carrier (ETC) to receive high-cost universal service support.[15] ETCs may be incumbent LECs, or non-incumbent LECs, which are referred to as "competitive ETCs."[16] Under the existing high-cost support distribution mechanism, incumbent LEC ETCs receive high-cost support for their intrastate services based on their costs.[17] Com-

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final proposal. *See* GTE's Comments in Response to Questions, CC Docket No. 96-45, Attach. 1 (filed Aug. 2, 1996).

[13] *See Universal Service First Report and Order*, 12 FCC Rcd at 8950, para. 324.

[14] *See Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[15] 47 U.S.C. § 254(e). The statutory requirements for ETC designation are set out in section 214(e) of the Communications Act of 1934, as amended (Communications Act or Act). 47 U.S.C. § 214(e).

[16] *See* 47 C.F.R. § 54.5 ("A 'competitive eligible telecommunications carrier' is a carrier that meets the definition of 'eligible telecommunications carrier' below and does not meet the definition of an 'incumbent local exchange carrier' in § 51.5 of this chapter.").

[17] Non-rural incumbent LEC ETCs receive support for their intrastate supported services based on the forward-looking economic cost of providing the services. 47 C.F.R. § 54.309. Rural incumbent LEC ETCs receive support based on their loop costs, as compared to a national average. 47 C.F.R. Part 36, sbpt. F; 47 C.F.R. § 54.305. Incumbent LEC ETCs that serve study areas with 50,000 or fewer lines receive support based on their local switching costs. 47 C.F.R.

petitive ETCs, on the other hand, receive support for each of their lines based on the per-line support the incumbent LEC receives in the service area.[18] This support to competitive ETCs is known as "identical support." The Commission's universal service high-cost support rules do not distinguish between primary and secondary lines; therefore, high-cost support may go to a single end user for multiple connections.[19] Further, the Commission's rules may result in multiple competitors in the same high-cost area receiving identical per-line support.

8. High-cost support for competitive ETCs has grown rapidly over the last several years, which has placed extraordinary pressure on the federal universal service fund.[20] In 2001, high-cost universal service support to-

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§ 54.301. Additionally, incumbent LEC ETCs that are subject to price cap or rate-of-return regulation receive interstate access support based on their revenue requirements. 47 C.F.R. Part 54, sbpts. J, K.

[18] 47 C.F.R. § 54.307(a).

[19] *See Universal Service First Report and Order*, 12 FCC Rcd at 8828-30, paras. 94-96.

[20] Support for the fund derives from assessments paid by providers of interstate telecommunications services and certain other providers of interstate telecommunications. *See* 47 C.F.R. § 54.706. Fund contributors are permitted to, and almost always do, pass those assessments th[r]ough to their end-user customers. *See* 47 C.F.R. § 54.712. Fund assessments paid by contributors are determined by applying the quarterly contribution factor to the contributors' contribution base revenues. In the second quarter of 2007, the contribution factor reached 11.7%, which is the highest level since its inception. *See Proposed Second Quarter 2007 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 22 FCC Rcd 5074, 5077 (OMD 2007). The contribution factor has since declined to 11.4% in the fourth quarter of 2008. *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD 2008).

taled approximately $2.6 billion.[21] By 2007, the amount of high-cost support had grown to approximately $4.3 billion per year.[22] In recent years, this growth has been due mostly to increased support provided to competitive ETCs, which pursuant to the identical support rule receive high-cost support based on the incumbent LEC's per-line support. Competitive ETC support, in the six years from 2001 through 2007, has grown from under $17 million to $1.18 billion—an annual growth rate of over 100 percent.[23] This "funded competition" has grown significantly in a large number of rural, insular, or high-cost areas; in some study areas, more than 20 competitive ETCs currently receive support.[24]

9. To address the growth in competitive ETC support, the Joint Board recommended an interim cap on the amount of high-cost support available to competitive ETCs, pending comprehensive high-cost universal ser-

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[21] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 3.2 (2007) (2007 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-279226A1.pdf.

[22] UNIVERSAL SERVICE ADMINISTRATIVE COMPANY, 2007 ANNUAL REPORT 43 (2007) (USAC 2007 ANNUAL REPORT), *available at* http://www.usac.org/_res/documents/about/pdf/usacannual-report-2007.pdf.

[23] 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 3.2; USAC 2007 ANNUAL REPORT at 45.

[24] *See* USAC Quarterly Administrative Filings for 2008, Fourth Quarter (4Q) Appendices, HC03—Rural Study Areas with Competition—4Q2008, *available at* http://www.usac.org/about/governance/fcc-fiings/2008/Q4/HC03%20%20?Rural%20Study%20Areas%20with%20Competition%20-%204Q2008.xls (showing 24 competitive ETCs in the study area of incumbent LEC Iowa Telecom North (study area code 351167), and 22 competitive ETCs in the study area of incumbent LEC Iowa Telecom Systems (study area code 351170)).

vice reform. The Commission adopted this recommendation in 2008.[25]

10. For the past several years, the Joint Board and the Commission have been exploring ways to reform the Commission's high-cost program. In the most recent high-cost support comprehensive reform efforts, the Joint Board issued a recommended decision on November 20, 2007.[26] The Joint Board recommended that the Commission address reforms to the high-cost program and make "fundamental revisions in the structure of existing Universal Service mechanisms."[27] Specifically, the Joint Board recommended that the Commission should: (1) deliver high-cost support through a provider of last resort fund, a mobility fund, and a broadband fund;[28] (2) cap the high-cost fund at $4.5 billion, the approximate

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[25] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 8998, 8999-9001, paras. 4-7 (JB 2007) (*Interim Cap Recommended Decision*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (2008) (*Interim Cap Order*). As recommended by the Joint Board, the Commission capped competitive ETC support for each state. *Interim Cap Recommended Decision*, 22 FCC Rcd at 9002, para. 9; *Interim Cap Order*, 23 FCC Rcd at 8846, paras. 26-28. The Commission set the cap at the level of support competitive ETCs were eligible to receive during March 2008. *Interim Cap Order*, 23 FCC Rcd at 8850, para. 38.

[26] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (JB 2007) (*Comprehensive Reform Recommended Decision*).

[27] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 1.

[28] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20480-81, para. 11.

level of 2007 high-cost support;[29] (3) reduce the existing funding mechanisms during a transition period;[30] (4) add broadband and mobility to the list of services eligible for support under section 254 of the Act;[31] (5) eliminate the identical support rule;[32] and (6) "explore the most appropriate auction mechanisms to determine high-cost universal service support."[33]

11. On January 29, 2008, the Commission released three notices of proposed rulemaking addressing proposals for comprehensive reform of high-cost universal service support.[34] In the *Identical Support NPRM*, the Commission sought comment on the Commission's rules governing the amount of high-cost universal service support provided to competitive ETCs.[35] It tentatively con-

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[29] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26.

[30] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 27.

[31] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481-82, paras. 12-18.

[32] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20486, para. 35.

[33] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, paras. 1-6.

[34] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1531 (2008) (*Joint Board Comprehensive Reform NPRM*) (collectively the *High-Cost Reform NPRMs*).

[35] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

cluded that the Commission should eliminate the identical support rule.[36] The Commission also tentatively concluded that support to a competitive ETC should be based on the competitive ETC's own costs of providing the supported services, and it sought comment on how the support should be calculated, the reporting obligations to be applied, and whether the Commission should cap such support at the level of the incumbent LEC's support.[37] In the *Reverse Auctions NPRM*, the Commission tentatively concluded that reverse auctions offer several potential advantages over current high-cost mechanisms and sought comment on whether they should be used as the disbursement mechanism to determine the amount of high-cost universal service support for ETCs serving rural, insular, and high-cost areas, and it sought comment on how to implement reverse auctions for this purpose.[38] The Commission also sought comment on a number of specific issues regarding auctions and auction design.[39] The Commission also released the *Joint Board Comprehensive Reform NPRM*, seeking comment on the *Joint Board's Comprehensive Reform Recommended Decision* and incorporating by reference the *Identical Support NPRM* and the *Reverse Auctions NPRM*.[40] The discussion that follows represents our response to the Joint Board's *Comprehensive Reform Recommended Decision*, pursuant to section 254(a)(2).[41]

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[36] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

[37] *Identical Support NPRM*, 23 FCC Rcd at 1473-78, paras. 12-25.

[38] *Reverse Auctions NPRM*, 23 FCC Rcd at 1495, para. 1.

[39] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500-12, paras. 10-50.

[40] *Joint Board Comprehensive Reform NPRM*, 23 FCC Rcd at 1531, para. 1.

[41] 47 U.S.C. § 254(a)(2). Pursuant to that section, the Commission shall complete any proceeding to implement a Joint Board recom-

B. Discussion

12. Today we comprehensively reform the high-cost universal service support mechanism, and take steps to ensure that broadband Internet access service is deployed quickly to all areas of the country, including rural and insular areas. The steps we take today will provide certainty to providers as to the levels of support available to them in providing supported services and broadband Internet access service to all customers within the supported areas. This will assist providers in creating business plans to deploy services in currently unserved areas and will ensure efficiency in the deployment of services to these areas. Specifically, we are defining the level of high-cost support available to providers that commit to offer broadband to all customers within a service area. For incumbent LECs, other than rural rate-of-reform incumbent LECs, support in incumbent LEC service areas will be set at the total amount of high-cost support disbursed to the incumbent LEC ETC in December 2008 on an annualized basis. For rural rate-of-return incumbent LECs, all high-cost universal service mechanisms will continue to operate as they do today through 2010, and then will be frozen at that level. Incumbent LEC ETCs will continue to receive this level of support if they commit to offer broadband Internet access services to all customers within the service area within five years. If an incumbent LEC does not make this broadband commitment for a particular service area, the support will be transitioned to the winning bidder of a reverse auction that will commit to deploy broadband throughout the service area within ten years, and to take on carrier of

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mendation within one year after receiving it. The Commission has acted on the *Comprehensive Reform Recommended Decision* prior to the November 20, 2008 one-year statutory deadline.

last resort obligations. For competitive ETCs, we adopt a five-year transition, during which their support will be reduced 20 percent each year. While ensuring that broadband Internet access service is made available to customers in rural and high-cost areas, with the exception of high-cost support for rural rate-of-return incumbent LECs, we also cap the overall size of the high-cost mechanism to protect customers in all areas of the nation from increasing universal service contribution assessments.

13. The requirements that we adopt for disbursement of high-cost universal service support do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions.[42] We find that these areas have very different attributes and related cost issues than do the continental states.[43] For this reason, we are exempt-

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[42] Providers operating in U.S. Territories and possessions, such as Puerto Rico and Guam, are not subject to the high-cost support requirements adopted in this order. *See* Letter from Earl Comstock, Comstock Consulting LLC, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-377 at 1 (dated Oct. 15, 2008) (asking the Commission to recognize the higher costs and lower income levels in Puerto Rico in any reform efforts it may take); Letter from Eric N. Votaw, Vice President—Marketing & Regulatory, GTA Telecom, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-45, WC Docket No. 05-337 at 1-2 (filed Oct. 24, 2008) (asking the Commission to recognize that Guam's costs are higher than the continental United States and that Guam should be treated separately, along with Alaska and Hawaii, for reform purposes).

[43] *E.g., Verizon Commc'ns, Inc., Transferor, and América Móvil, S.A. de C.V., Transferee*, WT Docket No. 06-113, Memorandum Opinion and Order and Declaratory Ruling, 22 FCC Rcd 6195, 6211, para. 36 (2007) (*Verizon/América Móvil Transfer Order*) (describing "difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Integration of Rates and Services for Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Is-*

ing providers in Alaska, Hawaii and U.S. Territories or possessions from the high-cost support requirements and rules adopted herein, and we will address them in a subsequent proceeding.[44]

1. Controlling the Growth of the High-Cost Fund

14. Consistent with the recommendation of the Joint Board, we cap the total amount of high-cost universal service support, with the exception of high-cost support for rural rate-of-return incumbent LECs.[45] As the Joint Board recognized, high-cost support currently accounts for more than half of total federal universal service sup-

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lands, CC Docket No. 83-1376, Supplemental Order Inviting Comments, 4 FCC Rcd 395, 396, paras. 7-8 (1989) (*Rates and Services Integration Order*) (describing the unique market conditions and structure in Alaska); Letter from Brita D. Strandberg, Counsel for General Communication, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 05-337 at 2 (Oct. 3, 2008) (discussing Alaska's particular service needs and network architecture).

[44] *Cf. The Establishment of Policies and Service Rules for the Broadcasting-Satellite Service at the 17.3-17.7 GHz Frequency Band and at the 17.7-17.8 GHz Frequency Band Internationally, and at the 24.75-25.25 GHz Frequency Band for Fixed Satellite Services Providing Feeder Links to the Broadcasting-Satellite Service and for the Satellite Services Operating Bi-directionally in the 17.3-17.8 GHz Frequency Band*, IB Docket No. 06-123, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 8842, 8860, para. 47 (2007) (*Policies and Service Rules for the Broadcasting-Satellite Service Order*) ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[45] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, 20481, 20484, paras. 2, 11, 26.

port.[46] Since 1997, when the Commission implemented the universal service requirements of section 254 of the Act, high-cost support has increased by 240 percent.[47] Although, earlier this year, we took an initial step to address high-cost fund growth by capping support to competitive ETCs, that cap was an interim, emergency measure, pending a closer examination of the steps necessary to achieve comprehensive reform.[48] Many commenters have urged the Commission to cap the overall amount of high-cost support, rather than limiting the cap only to competitive ETCs.[49] Although other commenters

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[46] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26. In 2007, total federal universal service disbursements amounted to approximately $6.95 billion. Of that amount, approximately $4.29 billion, 62%, was disbursed as high-cost support. USAC 2007 ANNUAL REPORT at 51.

[47] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at 3-14, tbl. 3.1 (high-cost support in 1997 was approximately $1.26 billion, compared with approximately $4.29 billion in 2007). Even taking into account the fact that additional interstate support mechanisms, Interstate Access Support (IAS) and Interstate Common Line Support (ICLS), were created in 2000 and 2001, respectively, high-cost support has still increased by more than 45%, from approximately $2.94 billion in 2002 to its current level of approximately $4.29 billion. *Id.*

[48] *See Interim Cap Order*, 23 FCC Rcd at 8834, para. 1.

[49] *See* CenturyTel *High-Cost Reform NPRMs* Comments at 18 (existing high-cost support mechanisms should be frozen at the study area level or on a statewide basis to provide funding certainty and encourage investment); Chinook *High-Cost Reform NPRMs* Comments, Attach. at 5-6 (any cap on universal service support should apply to all ETCs, including incumbent LECs); Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 5 (supporting a cap on high-cost support set at the 2007 level); Florida PSC *High Cost Reform NPRMs* Comments at 2 (supporting the recommendation to cap the overall size of the high cost fund); Information Technology Industry Council (ITI) *High-Cost Reform NPRMs* Comments at 7 (an overall cap should be applied to control the size of the high-cost mechanism); NCTA *High-Cost Reform NPRMs* Com

oppose the adoption of a cap on the total amount of high-cost support or on the amount of support available to incumbent LEC ETCs,[50] we find that, to manage the high-cost support mechanism effectively, we must control its growth, and that capping support in the manner discussed below will provide specific, predictable, and sufficient support to preserve and advance universal service.[51]

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ments at 19 (the Joint Board's proposal to cap the overall size of the high-cost mechanism is "a welcome dose of fiscal responsibility"); National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2-3 (supporting the Joint Board's proposal to cap the overall high-cost fund); Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 2-3, 6-9 (Commission should cap the overall high-cost fund).

[50] *See* Frontier *High-Cost Reform NPRMs* Comments at 6-7; JSI *High-Cost Reform NPRMs* Comments at 6; Montana Telecommunications Ass'n *High-Cost Reform NPRMs* Comments at 21-22; NECA *High-Cost Reform NPRMs* Comments at 17-20; TCA *High-Cost Reform NPRMs* Comments at 10-11; TDS *High-Cost Reform NPRMs* Comments at 8-9; Missouri Small Telephone Company Group (MSTC) *High-Cost Reform NPRMs* Reply at 5-7; Utah Rural Telecom Ass'n *High-Cost Reform NPRMs* Reply at 5.

[51] 47 U.S.C. § 254(b)(5); *see* CenturyTel *High-Cost Reform NPRMs* Comments at 18; Comcast *High-Cost Reform NPRMs* Comments at 3, 11; Florida PSC *High-Cost Reform NPRMs* Comments at 8-9; National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2; NCTA *High-Cost Reform NPRMs* Comments at 4-6; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Comments at 52-54; Oregon PUC *High-Cost Reform NPRMs* Comments at 2-3; Sprint Nextel *High-Cost Reform NPRMs* Comments at 3; USTelecom *High-Cost Reform NPRMs* Comments at 2; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 7; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Reply at 64-65; Sprint Nextel *High-Cost Reform NPRMs* Reply at 8-9; State Commissioners *High-Cost Reform NPRMs* Reply at 2; Texas Office of Public Utility Counsel *Joint Board Comprehensive Reform NPRM* Reply at 2; Virgin Mobile *High-Cost Reform NPRMs* Reply at 3-4. The Commission has al-

15. We find it necessary to cap the high-cost mechanism as a first step toward fulfilling our statutory obligation to create specific, predictable and sufficient universal service support mechanisms.[52] As the United States Court of Appeals for the Fifth Circuit held in *Alenco*: "[t]he agency's broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service."[53] The *Alenco* court also found that "excessive funding may itself violate the sufficiency requirements,"[54] and the United States Court of Appeals for the Tenth Circuit has stated that "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in [section] 254(b)(1)."[55] Given the excessive growth in high-cost support, we find it necessary to cap this mechanism to ensure that unsubsidized users who contribute to the fund are not harmed by excessive subsidization.

16. Therefore, we take several steps to limit the growth of high-cost support. First, excluding support to rural rate-of-return incumbent LECs, we cap the overall

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ready implemented caps on the schools and libraries and rural health care universal service mechanisms. *Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704 (establishing a $2.25 billion annual cap for the schools and libraries mechanism and a $400 million annual cap for the rural health care mechanism); *see also* 47 C.F.R. §§ 54.507(a), 54.623(a).

[52] 47 U.S.C. § 254(b)(5); *see also Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704.

[53] *Alenco Comme'ns, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000) (*Alenco*).

[54] *Alenco*, 201 F.3d at 620.

[55] *Qwest Comme'ns Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

high-cost fund at the total amount of high-cost support disbursed by the Universal Service Administrative Company (USAC) for December 2008 on an annualized basis, net of any prior or past period adjustments. Although we agree with the Joint Board's recommendation to cap the high-cost mechanism, rather than set such a cap at the 2007 level of high-cost support as the Joint Board recommended, we find it is more appropriate to set the cap at the level of support disbursed by USAC in December 2008 on an annualized basis. Furthermore, for incumbent LECs other than rural rate-of-return incumbent LECs, we freeze each incumbent LEC ETC's individual, annual high-cost support at the amount of support, on a lump sum basis, that the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[86] For rural rate-of-return incumbent LECs, all high-cost universal service support mechanisms utilized by rural rate-of-return incumbent LECs continue to operate as the[y] do today through 2010. This includes high-cost loop support (HCLS), local switching support (LSS), interstate common line support (ICLS), safety net additive support, and

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[86] Pursuant to section 214(e)(5) of the Act, the term "service area" is used to refer to the geographic area established by a state commission or this Commission for the purpose of determining universal service obligations and support mechanisms. 47 U.S.C. § 214(e)(5). For a rural telephone company, section 214(e)(5) states that "service area" shall mean the rural company's "study area" unless and until the Commission and the states establish a different definition of service area for such company. *Id.* In this order, we use the terms "service area" and "study area" interchangeably. Nothing in this order is meant to change any redefinitions of service area previously established by the Commission and/or the state commissions.

safety valve support. Support from these mechanisms will be frozen by study area at 2010 levels.[57]

17. As discussed below, for competitive ETCs, we provide a five year transition, during which their support is reduced in equal steps.[58] More specifically, for each competitive ETC, a base-line level of support will be determined based on the total support received by that competitive ETC for the twelve months prior to the effective date of the order. For the twelve months following the effective date of the order, each competitive ETC will receive support equal to 80 percent of its baseline support amount. In year two, each competitive ETC will receive support equal to 60 percent of its baseline support amount. In year three, each competitive ETC will receive support equal to 40 percent of its baseline support amount. In year four, each competitive ETC will receive support equal to 20 percent of its baseline support amount. Finally, in year five, existing high-cost support for competitive ETCs will be eliminated.

18. Consistent with section 254(b)(5) of the Act, we find that capping high-cost support in this manner will enable ETCs to predict the specific level of support that they will receive should they choose to participate in the program.[59] To the extent that an incumbent LEC ETC determines that it cannot offer broadband Internet ac-

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[57] Letter from John N. Rose, President, OPASTCO, and Kelly Worthington, Executive Vice President, WTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, 01-92, WC Docket No. 05-337, Attach. at 2 (filed Oct. 29, 2008) (Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter).

[58] Letter from Paul W. Garnett, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, 06-122 at 1 (filed Oct. 22, 2008) (CTIA Oct. 22, 2008 *Ex Parte* Letter).

[59] 47 U.S.C. § 254(b)(5).

cess service throughout its service area at the specified level of support, as discussed below, that particular study area will be deemed an "Unserved Study Area," and we will conduct a reverse auction to determine the entity capable of meeting our service requirements and the amount of support to provide for that area. In fact, through the reverse auction process, it will be the bidders, not the Commission, that determine how much support they would need to offer service. Finally, as discussed below, if the reverse auction process does not yield a winning bidder, the Commission will reexamine whether it needs to take further action with regard to this situation, should it arise.

2. Conditioning Support on Offering Broadband Internet Access Service

19. The broadband era is here. Those of us who have broadband Internet access service use it to communicate, to work, to get vital information, to be educated, and to be entertained. Broadband Internet access service—a novelty at the time of the passage of the 1996 Act—is now mainstream. Yet some Americans still lack access to this vital service, and as Commissioner Copps has said, "does America at the beginning of the 21st century become technologically stagnant or the leader of the Digital Age? For me, the answer to that question depends in some significant measure upon whether we succeed in bringing high-speed, high-value broadband and an open Internet to all Americans . . . rural as well as urban folks . . . ."[60]

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[60] Remarks of Commissioner Michael J. Copps, Pike & Fischer's Broadband Policy Summit IV, Washington, DC (June 12, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-282890A1.pdf.

20. Today, we modify our high-cost support system fundamentally to spur deployment and ensure that all Americans have access to broadband. Specifically, for incumbent LECs, we make offering broadband Internet access service a condition of being eligible to receive high-cost support. As we explain below, we will require all incumbent LECs to certify whether or not they will commit to offering broadband Internet access throughout their supported study areas in five years.[61] Those

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[61] *See supra* note 56 (explaining use of the terms "study area" and "service area" in this order). We understand the concern of commenters who point out the need for more granular information on broadband availability. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481, para. 13; *see also* Comcast *High-Cost Reform NPRMs* Comments at 13-16; GCI *High-Cost Reform NPRMs* Comments at 34-36; NCTA *High-Cost Reform NPRMs* Comments at 20; New Jersey Rate Counsel *High-Cost Reform NPRMs* Comments at 21-22; New York State PSC *Joint Board Comprehensive Reform NPRM* Comments at 1, 5-6; TCA *High-Cost Reform NPRMs* Comments at 11-12; USTelecom *High-Cost Reform NPRMs* Comments at 36; Embarq *High-Cost Reform NPRMs* Reply at 8-10. The Commission has recently undertaken a major effort to gather more specific and granular data about broadband subscribership and availability. *See Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 9691, 9708-09, paras. 34-35 (2008) (*Broadband Data Gathering Order*) (seeking comment on, among other things, adopting a national broadband mapping program). We believe our refined broadband data gathering program will help all of us better assess where our broadband availability needs are greatest. For purposes of implementing the broadband deployment program of this order, we ask incumbent LECs to identify where they will and will not commit to broadband availability, thus identifying where we need to proceed to a reverse auction.

who make that commitment will continue to receive their current levels of support. Auction winners, as well, must commit to offering broadband Internet access service throughout their supported areas as a condition of receiving even initial support. We also explain the obligations related to this condition, including carrier-of-last-resort-type obligations.

21. We believe that imposing this condition on the receipt of high-cost support for incumbent LECs and auction winners is fully consistent with and indeed promotes Congress's overall objectives as stated in section 254 of the Communications Act and section 706 of the 1996 Act.[62] Section 254(b)(2) of the Act instructs the Commis-

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[62] 47 U.S.C. §§ 157 nt, 254. Some commenters suggest that adding broadband Internet access service to the list of "supported services" would be inconsistent with section 254(c)(1) of the Act because broadband Internet access service is an information service, not a telecommunications service. *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 30-31; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 31-32; SouthernLINC *High-Cost Reform NPRMs* Reply at 42-43; Sprint Nextel *High-Cost Reform NPRMs* Reply at 16-17. Using the universal service program to ensure universal broadband availability, however, is fully consistent with the statute as explained above. In addition, section 254(c)(2) provides that "[t]he Joint Board may, from time to time, recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms." 47 U.S.C. § 254(c)(2). The Joint Board did just that in the *Comprehensive Reform Recommended Decision*, in which it recommended that we add broadband Internet access service to the list of services eligible for support under section 254. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20491, para. 56. In this order, we achieve the Joint Board's goal by conditioning receipt of federal high-cost support on an ETC's commitment to offer broadband Internet access service throughout its service area, but we do not add broadband Internet access service to the list of universal service supported services.

sion to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[63] Similarly, section 254(b)(3) states that "[c]onsumers . . . in rural, insular, and high-cost areas, should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[64] Indeed, Congress even established the definition of universal service as "an *evolving* level of telecommunications services . . . taking into account advances in telecommunications and information technologies and services."[65] We believe that imposing a broadband condition on receipt of high-cost support by incumbent LECs and auction winners advances the general purposes of section 254 of the Act as just described and also advances Congress's objective stated in section 706 of the 1996 Act to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."[66] We also see no reason why conditioning the receipt of high-cost support on offering broadband Internet access service is not permissible under the Commission's authority to promulgate general rules related to universal service.[67]

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[63] 47 U.S.C. § 254(b)(2) (emphasis added).

[64] 47 U.S.C. § 254(b)(3) (emphasis added).

[65] 47 U.S.C. § 254(c)(1) (emphasis added).

[66] 47 U.S.C. §§ 157 nt, 254.

[67] The Commission has previously considered imposing conditions on the receipt of high-cost support. *See Universal Service First Report and Order*, 12 FCC Rcd at 8831, para. 98. And of course, today's recipients of high-cost support must comply with many obligations that are not explicitly spelled out in the statute. For example, to be

22. *Broadband Internet Access As a Condition to Receiving High-Cost Support.* Consistent with the objectives of sections 254 and 706 as just described, all incumbent LECs and auction winners must offer broadband Internet access service to all customers in their supported service areas as a condition of receiving universal service high-cost support. Since the Commission adopted universal service rules in response to the 1996 Act, broadband Internet access service has evolved into a critical service for American consumers. The importance of this evolution is reflected in Congress's recent finding that "[t]he deployment and adoption of broadband technology has resulted in enhanced economic development and public safety for communities across the Nation, improved heath care and education opportunities, and a better quality of life for all Americans, [and] [c]ontinued progress in the deployment and adoption of broadband technology is vital to ensuring that our Nation remains competitive and continues to create business and job growth."[68] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and so many other uses.[69] Broadband

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designated as an ETC, an applicant must demonstrate that it has back-up power. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 20 FCC Rcd 6371, 6382, para. 25 (2005) (*ETC Designation Order*).

[68] Broadband Data Improvement Act, Pub. L. No. 100-385, 122 Stat. 4096, § 102(1)-(2) (2008).

[69] A recent survey finds that, compared to Internet users with dial-up service at home, those with broadband service at home are far more likely to engage in 14 different types of Internet-related activities on a typical day. These activities include using an online search engine, checking for weather reports, getting news, visiting a state

Internet access plays a special role in rural areas, reducing the burdens of distance.[70] For example, high-speed connections to the Internet allow children in rural areas to have access to the same information as school children in urban areas. Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare in sparsely populated, rural areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[71] Broadband service also enables the sharing of critical, time-sensitive information with first responders, government officials, and health care provid-

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or local government Web site, obtaining job information, watching a video, and downloading a podcast. The daily use of a search engine, for example, is reported by 57% of the broadband users as compared to only 26% of the dial-up users. *See* JOHN B. HORRIGAN, PEW INTERNET & AMERICAN LIFE PROJECT, HOME BROADBAND ADOPTION 2008 at 19 (2008) (2008 PEW BROADBAND ADOPTION STUDY), *available at* http://www.pewinternet.org/pdfs/PIP_Broadband_ 2008.pdf.

[70] For example, the California Broadband Task Force Report finds broadband service critical to expanding job opportunities for rural residents. It observes, for example, that broadband has facilitated the use of "homeshoring," or the use of home-based workers for providing customer service, instead of requiring employees to adhere to a strict work schedule at a centralized location. This report also finds that broadband offers farmers better access to market information and allows them to expand their potential customer base. *See* FINAL REPORT OF THE CALIFORNIA BROADBAND TASK FORCE at 13 (Jan. 2008) (CALIFORNIA 2008 BROADBAND REPORT), *available at* http://www.calink.ca.gov/taskforcereport/.

[71] *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111, 11112, para. 5 (2006); *see also* SUSANNAH FOX, PEW INTERNET & AMERICAN LIFE PROJECT, THE ENGAGED E-PATIENT POPULATION at 1 (2008) (finding that home broadband users are twice as likely as home dial-up users to do health research on a typical day), *available at* http://www.pewinternet.org/pdfs/PIP_Health_Aug08.pdf.

ers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis in coordination.[72]

23. Despite the advances in broadband technology and the deployment of infrastructure to accommodate higher bandwidth speeds, ubiquitous broadband availability does not exist throughout the nation—especially for those consumers in rural areas.[73] In March 2008, the Commission's most recent data revealed that more than half of the households in the United States now subscribe to a high-speed service provider and at least one high-speed service provider is providing service in excess of 200 kbps in at least one direction in 99.9 percent of zip codes in the country.[74] The broadband subscription rate is much lower in rural areas, however. A 2008 survey finds that the percentage of rural households subscribing to broadband service is only 38 percent—well below the 57 percent and 60 percent subscription rates found in ur-

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[72] A recent report to Congress concludes that "[m]odern broadband communications networks and applications present an enormous opportunity to radically improve the manner in which emergency information is shared by health officials. Broadband services enable bandwidth intensive information such as video, pictures, and graphics to be transmitted faster and in a more reliable and secure manner." JOINT ADVISORY COMMITTEE ON COMMUNICATIONS CAPABILITIES OF EMERGENCY MEDICAL AND PUBLIC HEALTH CARE FACILITIES, REPORT TO CONGRESS 2 (Feb. 4, 2008), *available at* http://energycommerce.house.gov/Press_110/JAC.Report_FINAL.%20Jan.3.2008.pdf.

[73] *See, e.g.*, Cellular South *High-Cost Reform NPRMs* Comments at 10; *see also generally* 2008 PEW BROADBAND ADOPTION STUDY at 11-12.

[74] *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl. 15 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-280906A1.pdf.

ban and suburban areas, respectively.[75] This survey concludes that the lack of broadband availability very likely accounts for some of this disparity.[76] Moreover, this conclusion is consistent with the results of residential surveys in several states.[77] We find that making the offering of broadband Internet access service a condition of re-

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[75] *See* 2008 PEW BROADBAND ADOPTION STUDY at 3-4. The survey was conducted by phone from April 8, 2008 to May 11, 2008 among 2,251 American adults, 1,153 of whom were broadband users. *Id.*

[76] Pew acknowledges that the participants in its 2008 survey may report incorrectly as to whether broadband service is available where they live. 2008 PEW BROADBAND ADOPTION STUDY at 11. Pew nonetheless concludes that "the fact that rural residents are more likely to report that broadband isn't available where they live indicates that infrastructure availability comes into play in broadband adoption. Some 28% of rural adult Americans without home high-speed say broadband isn't available where they live, in contrast to 22% of non-rural Americans without broadband who say this. Moreover, 24% of dial-up users in rural areas say having the service available where they live would prompt a switch to broadband; this compares to the 14% figure for all respondents." *Id.* at 11-12.

[77] In Ohio, a March 2008 survey of 1,200 residents found broadband service available in 96% of urban homes but in only 79% of rural homes. *See* CONNECT OHIO TECHNOLOGY ASSESSMENT: EXECUTIVE SUMMARY at 2 (June 27, 2008), *available at* http://connectoh.org/_documents/Res_OHExecutiveSummary06252008_FINAL.pdf. In California, a state-commissioned task force recently found that approximately 500,000 California households, or almost 1.4 million California residents, are unable to subscribe to broadband service with a speed of at least 500 kbps. The task force identified 1,975 communities without broadband service and concluded that many California communities do not have access to the higher broadband speeds. *See* CALIFORNIA 2008 BROADBAND REPORT at 33. In Tennessee, a July 2007 survey of 1,787 residents having dial-up service at home found that 36% of them did not subscribe to broadband service because it was unavailable to their homes. *See* CONNECTED TENNESSEE, TENNESSEE RESIDENTIAL CONSUMERS at 22 (2007), *available at* http://www.connectedtn.org/_documents/CTResidentialSurvey100107.FINAL.pdf

ceiving universal service high-cost support can bring this critical service to the remainder of Americans who await its deployment.[78] In addition, doing so will further the objective of section 254(b)(3) that consumers in rural, insular, and high-cost areas have access to advanced telecommunications and information services that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas.[79]

a. Definition of Broadband Internet Access Service

24. For purposes of satisfying the condition to receive high-cost support, we adopt a definition of broadband Internet access service that focuses on the end user's experience, without regard to the types of facilities, protocols, or other technologies used to deliver that experience. Broadband Internet access service is therefore defined as an "always on" service that combines computer processing, information provision, and computer interac-

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[78] We disagree with commenters who suggest that it is premature or ill-advised to require all ETCs to offer broadband because, as discussed below, we do so in a manner that does not increase the size of the high-cost fund. *See, e.g.*, SouthernLINC *High-Cost Reform NPRMs* Comments at 30; Sprint Nextel *High-Cost Reform NPRMs* Comments at 16-17; USTelecom *High-Cost Reform NPRMs* Comments at 33-34; Western Telecomms. Alliance (WTA) *High-Cost Reform NPRMs* Comments at 73; SouthernLINC *High-Cost Reform NPRMs* Reply at 41. Similarly, we disagree with commenters who argue that government action at the current time would be wasteful as the market is already taking steps to reach currently underserved areas. *See, e.g.*, NCTA *High-Cost Reform NPRMs* Comments at 19-20; SouthernLINC *High-Cost Reform NPRMs* Comments at 30; SouthernLINC *High-Cost Reform NPRMs* Reply at 42. We cannot wait indefinitely for the benefits of broadband to reach all Americans.

[79] See 47 U.S.C. § 254(b)(3).

tivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed elsewhere in this order.[80] We refer specifically to broadband Internet access service—an information service—and not to broadband transmission alone because our goal is to ensure that all Americans have access to the Internet.[81]

b. Broadband Internet Access Service Obligations

25. Section 254(b)(1) instructs the Commission to base policies for the advancement of universal service on the principle that quality services should be offered at just, reasonable, and affordable rates.[82] Below we provide requirements for offering broadband Internet access service as a condition of receiving universal service high-cost support. In sum, all incumbent LECs and auction winners must offer broadband Internet access service, along with all supported services, to all customers throughout their service areas by the end of a five- or ten-year build-out period consistent with the requirements of this order.

26. Except as described just below, an incumbent LEC or auction winner may offer broadband Internet access service using any technology, or combination of

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[80] *See infra* paras. 28, 45; *see also Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14860-61, para. 9 (2005) (*Wireline Broadband Internet Access Order*), *aff'd sub nom. Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

[81] As explained below, nothing in this order changes the choice that providers have today to offer broadband transmission on a common carrier basis. *See infra* para. 26.

[82] 47 U.S.C. § 254(b)(1).

technologies, that meets the requirements for speed set forth in this order. An incumbent LEC or auction winner may also combine services provided over its own facilities with those provided over another provider's facilities pursuant to agreement. Indeed, there may be service areas where it is more economic to offer broadband Internet access service via one technology than another and we explicitly provide for even a single provider to take advantage of the inherent benefits of different technologies for different areas.[83] Furthermore, an incumbent LEC or auction winner can combine a common carrier offering of broadband transmission[84] with the information processing capabilities described above,[85] so long as what the end user receives is in fact broadband Internet access service.

27. In general, an incumbent LEC or auction winner cannot use satellite broadband technology to meet its obligations under this order absent a waiver from the Commission. We are concerned that broadband Internet access service provided via satellite differs from broadband Internet access provided over other technologies in two important ways. First, satellite-provided broadband Internet access service is subject to latency due to the amount of time it takes a signal to travel between the satellite and the user.[86] Latency ranges from a quarter of

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[83] Thus, we are not favoring wireline technology over another. *But see* Virgin Mobile *High-Cost Reform NPRMs* Reply at 5-6.

[84] *See Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14900-01, paras. 89-90 (giving providers of wireline broadband Internet access the choice to offer broadband transmission on a common carrier basis or a non-common carrier basis).

[85] *See supra* para. 24.

[86] *See, e.g.*, COMPUTER SCIENCE AND TELECOMMUNICATIONS BOARD, NATIONAL RESEARCH COUNCIL, BROADBAND: BRINGING HOME THE

a second to almost a second, making the use of applications that require a very fast response difficult or impossible, and substantially degrading the quality of other applications like voice over Internet protocol.[87] Second, satellite-provided broadband Internet access service is subject to degradation due to weather events ("rain fade") to a greater degree than other wireless technologies.[88] For these reasons, we find that satellite-provided

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BITS 145 (2002) (BRINGING HOME THE BITS); BroadbandInfo.com, Inside the World of Satellite Broadband, BroadbandInfo.com, http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last visited Nov. 3, 2008) (stating that because the satellites providing broadband signals orbit the earth approximately 22,300 miles above the surface, there is a lag time between the sending and receiving of the satellite broadband signal).

[87] *See* BRINGING HOME THE BITS 145 (explaining that for Internet telephony, the delay can cause a real degradation in usability); Jon Norwood, Overview of Satellite Internet—Comparing the Main Features of Broadband Satellite (Oct. 17, 2006), *available at* http://www.velocityguide.com/satellite/satellite-internet-comparison.html (last visited Oct. 24, 2008) (stating that signal delay to a satellite ranges from around 500 to 900 milliseconds, and that this latency can render any software that requires real-time user input problematic at best); BroadbandInfo.com, Inside the World of Satellite Broadband, *available at* http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last visited Oct. 24, 2008) (stating that for certain broadband Internet real-time applications, such as e-gaming, the latency is enough to cause severe interference with the application).

[88] *See, e.g., Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, Second Report, 15 FCC Rcd 20913, 20938, para. 59 (2000) (explaining that areas subject to extreme rain or snow may have difficulty receiving satellite signals in those conditions, and describing it as a limitation to satellite Internet last-mile facilities); *see also* Howstuffworks.com, How Does Satellite Internet Operate?, http://computer.howstuffworks.com/question606.html (last visited Oct. 24, 2008) (explaining that, as for satellite TV, heavy rains can affect

broadband Internet access service cannot be the primary means by which we serve rural America. We recognize, however, that for certain customers, satellite-provided broadband may be the only economic means of reaching them. Therefore, all incumbent LECs and auction winners may apply to the Commission for a waiver to be able to meet their commitments under this order by offering broadband Internet access service via satellite to certain customers, based on a specific, detailed showing that there is no other economic option for serving those customers.[89] If the Commission grants such a waiver with regard to particular customers, that waiver may be transferred if a different ETC becomes subject to the obligation to offer broadband to those customers. In addition, we adopt the OPASTCO/WTA proposal that we create a "limited automatic exception for high-cost loops" for rural rate-of-return incumbent LECs. More specifically, OPASTCO/WTA propose: "The broadband build-out requirement has a limited automatic exception for very high-cost loops and allows rural RoR ILECs to serve those customers by satellite without filing a waiver request. A very high-cost loop is defined as a loop in which the additional cost to provide broadband is in excess of 150 percent of the carrier's study area average loop cost.

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reception of Internet signals); Skycasters, Broadband Satellite Internet: 99.44% System Reliability, http://www.skycasters.com/satellite-internet-service-specs/system-reliability.html (last visited Oct. 31, 2008) (explaining that rain fade is a short duration period during which the loss of satellite service occurs when intense storm cells are located directly between the satellite and the satellite dish).

[89] If an incumbent LEC or auction winner is permitted to use satellite service, the ETC may not charge a higher price to customers served by satellite than it charges to customers served by another broadband technology.

The automatic exception cannot apply to more than two percent of a carrier's total loops within a study area."[90]

3. Incumbent LECs' Commitment to Offer Broadband

28. As discussed above, as a condition of receiving federal high-cost universal service support, all incumbent LECs and auction winners must offer broadband Internet access service.[91] Therefore, incumbent LECs receiving high-cost support must certify to the Commission, for each study area[92] for which they receive high-cost support, whether or not they will offer broadband Internet access service to all customers within that study area, consistent with the requirements of this order, within five years of the due date of their commitment.[93] This certification must include a commitment to offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[94]

29. Incumbent LECs that file a certification for a particular study area indicating that they will offer broadband Internet access service under the terms specified in this order will continue to receive their current

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[90] Corrected OPASTCO/WTA Oct. 29 *Ex Parte* Letter, Attach. at 2.

[91] *See supra* paras. 19-27.

[92] *See supra* note 56 (explaining the use of the terms "study area" and "service area" in this order).

[93] The Wireline Competition Bureau (Bureau) will release a public notice at a future date specifying the manner and due date of the certification. Other reporting, monitoring, and milestone requirements are set forth below. *See infra* paras. 57-63.

[94] This tier of broadband is similar to the tier described as "Basic Broadband Tier 1" in our *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700-01, para. 20 & n.66.

levels of high-cost support for that study area, which will be deemed a "Committed Study Area." We specify the precise benchmarks that the incumbent LEC must meet over the five-year build-out period, and the consequences for failure to do so, below.[95]

30. As discussed above, except for rural rate-of-return incumbent LECs, we freeze each incumbent LEC ETC's individual high-cost support at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[96] For rural rate-of-return incumbent LECs, all high-cost universal service mechanisms will continue to operate as they do today through 2010, and then will be frozen at that level. Incumbent LEC ETCs committing to offer broadband Internet access service within a study area consistent with the requirements of this order will continue to receive the frozen high-cost support amount for that study area.[97]

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[95] *See infra* paras. 57-63.

[96] *See supra* para. 16.

[97] Some incumbent LECs assert that they will not be able to commit to provide broadband Internet access service to all customers within their study areas at the frozen level of support. *See, e.g.*, Letter from Eric N. Einhorn, V.P. Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 06-122, 08-152, 07-135, at 3 (filed Oct. 27, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket No. 05-337, at 2 (filed Oct. 20, 2008); Letter from Daniel Mitchell, Vice President Legal & Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 04-36, at 1-2 (filed Oct. 28, 2008). First, to the extent incumbent LECs cannot build out their networks to provide broadband to all customers in their study areas, they may seek a waiver to provide service via satellite technology, as discussed

31. Study areas for which incumbent LECs either certify that they will not offer broadband in five years as described herein, or for which the incumbent LECs fail to file any certification at all, will be deemed "Unserved Study Areas." For these areas, the Commission will conduct a reverse auction as described below, awarding high-cost support to a bidder that will commit to take on carrier of last resort obligations and to offer broadband Internet access service throughout the study area.

4. Reverse Auctions for Study Areas Unserved by Broadband

32. The Joint Board recommended that the Commission's universal service goals include universal availability of broadband Internet service at affordable and comparable rates for all rural and non-rural areas.[98] While we are not adopting the Joint Board's recommendation to create a separate broadband fund, we agree

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above. Second, universal service support is not meant to subsidize high-cost carriers, but rather it is meant to support customers in high-cost areas. *See Alenco*, 201 F.3d at 620 ("The Act only promises universal service, and that is a goal that requires sufficient funding of customers, not providers. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well."). Therefore, if an incumbent LEC cannot provide broadband service at the frozen support levels, support will go to a reverse auction winning bidder who can provide such service at or below that level on a more efficient basis. Third, as discussed below, to the extent that a reverse auction does not produce a winning bidder, the Commission will reexamine support to that study area. Finally, for rural rate-of-return incumbent LECs, all high-cost universal service mechanisms will continue to operate as they do today through 2010, and then will be frozen at that level.

[98] *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20491-92, paras. 56-62.

with the Joint Board's goal that broadband Internet access service should be universally and affordably available. We are therefore allowing incumbent LECs receiving high-cost support to continue to receive such support if they commit to offer broadband services throughout their supported service areas by the end of a five-year build-out period. We anticipate, however, that in some study areas, the incumbent LEC may decline to make that commitment. For these Unserved Study Areas, we will conduct a reverse auction for the right to receive high-cost support.[99]

33. We sought comment in our *Reverse Auctions NPRM* on the merits of using reverse auctions, a form of competitive bidding, to decide how much high-cost support to provide to ETCs serving rural, insular, and high-cost areas.[100] In a reverse auction, support generally would be determined by the lowest bid to serve the auctioned area.[101] We conclude that using a reverse auction method for identifying both the recipient of high-cost support for an Unserved Study Area, as well as the amount of support, is appropriate because the winning bid should approach the minimum level of subsidy required to achieve our universal service goals.[102] In con-

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[99] Many commenters, in particular those representing rural telephone companies, opposed the use of reverse auctions to award high-cost support to carriers of last resort in rural areas. *See, e.g.*, OPASTCO *Reverse Auctions* Comments at 16-21; NTCA *Reverse Auctions* Comments at 30-46. Under the measures we adopt today, reverse auctions will be conducted only in study areas for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service.

[100] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 10.

[101] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[102] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs*

trast, a support mechanism based on cost or on a cost model provides no incentive for an ETC to provide supported services at the minimum possible cost.[103] In addition, a reverse auction provides a fair and efficient means of eliminating or reducing the subsidization of multiple ETCs in a given region.[104] For these reasons, we find that a reverse auction offers advantages over the current high-cost support distribution mechanisms and we adopt a reverse auction plan, as discussed below.[105]

34. To implement the reverse auctions, there are several issues that must be addressed. We describe in this part: (1) the geographic area to be auctioned; (2) the reserve price for the reverse auction; (3) what a winning bidder will receive; (4) how the winning bidder will be selected; and (5) the qualifications a bidder must demonstrate before it may participate in a reverse auction.

Comments at 7 (supporting reverse auctions as a means of controlling and reducing the size of the universal service fund, while putting the burden on providers to estimate bid amounts); Comcast *High-Cost Reform NPRMs* Comments at 7 (noting that the use of reverse auctions could reduce the size of the high-cost fund significantly).

[103] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Letter from Grover Norquist, Americans for Tax Reform, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 1 (filed Apr. 14, 2008) (arguing that reverse auctions will create incentives to invest in rural communities and will not finance and subsidize wasteful carriers).

[104] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[105] Although several rural LEC commenters oppose the use of reverse auctions to distribute high-cost support, as discussed above, incumbent LECs will not be required to participate in a reverse auction to receive support, so long as they commit to deploy broadband throughout their study areas. *See, e.g.*, ATA *High-Cost Reform NPRMs* Comments at 13-15 (opposing the use of reverse auctions); Alexicon *Reverse Auctions NPRM* Comments at 2-3 (opposing reverse auctions for rural LECs).

a. Geographic Area

35. In the *Reverse Auctions NPRM*, we sought comment on whether we should use the study area[106] as the geographic area for reverse auctions.[107] We observed that high-cost support today is generally based on the wireline incumbent LEC's study area.[108] We tentatively concluded that the wireline incumbent LEC's study area would be the appropriate geographic area on which to base reverse auctions.[109] We adopt our tentative conclusion that the study area is the best geographic area to use for several reasons. First, if we allowed bidders to bid to provide service in smaller geographic areas, we would encourage bidders to bid on areas that are easier or cheaper to serve, leaving our most difficult-to-serve populations still without broadband service.[110] Conver-

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[106] A study area is a geographic segment of an incumbent LEC's telephone operations. Generally, a study area corresponds to an incumbent LEC's entire service territory within a state. *Direct Communications Cedar Valley, LLC and Qwest Corporation Joint Petition for Waiver of the Definition of "Study Area" of the Appendix-Glossary of Part 36 of the Commission's Rules, Petition for Waiver of Section 69.2(hh) and 69.605(c) of the Commission's Rules*, CC Docket No. 96-45, Order, 20 FCC Rcd 19180, 19181, para. 2 (WCB 2005). Section 54.207 of the Commission's rules provides that a rural telephone company's service area will be its study area "unless and until the Commission and the states, after taking into account recommendations of a Federal-State Joint Board instituted under section 410(c) of this Act, establish a different definition of service area for such company." 47 C.F.R. § 54.207(b); 47 U.S.C. § 214(e)(5). As discussed above, we use the terms "study area" and "service area" interchangeably in this order. *See supra* note 56.

[107] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20.

[108] *Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20.

[109] *Reverse Auctions NPRM*, 23 FCC Rcd at 1504, para. 21.

[110] Thus, we disagree with commenters' arguments that we should hold auctions for small geographic areas, such as counties, census

sely, if we required bidders to bid on even larger geographic areas, we might discourage bidders from entering the auction because of the difficulty in committing to serve an even larger area. Although some commenters oppose using the incumbent LEC's study area,[111] use of the study area is consistent with the area we ask incumbent LECs to consider in making their commitments. Finally, selecting smaller geographic areas for auction would increase the number of auctions to be held, potentially delaying the conduct of the auction and, therefore, the deployment of broadband to unserved areas.[112] For these reasons, we conclude that the study area is the best available geographic area to consider for the auction. We will conduct a reverse auction for each study area for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service pursuant to the requirements explained above (Unserved Study Areas).[113]

b. Reserve Price

36. In the *Reverse Auctions NPRM*, we noted that we should establish a reserve price—a maximum level of

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block groups, or zip codes. *See, e.g.*, Comcast *High-Cost Reform NPRMs* Comments at 9; NCTA *High-Cost Reform NPRMs* Comments at 16; SouthernLINC *High-Cost Reform NPRMs* Comments at 24-25; TracFone *High-Cost Reform NPRMs* Comments at 6.

[111] *See, e.g.*, Comcast *High-Cost Reform NPRMs* Comments at 8-9; NCTA *High-Cost Reform NPRMs* Comments at 16; SouthernLINC *High-Cost Reform NPRMs* Comments at 25; TracFone *High-Cost Reform NPRMs* Comments at 5.

[112] *See* Ohio PUC *Reverse Auctions NPRM* Comments at 6-7 (generally agreeing that the incumbent LEC's study area is the appropriate geographic area on which to base reverse auctions because further disaggregation could add cost and delays, and increase the opportunity for creamskimming).

[113] *See supra* paras. 19-31.

high-cost support that participants in the auction would be allowed to place as a bid.[114] We observed that a reserve price that is set too low is likely to discourage bidders from participating, while one that is set too high raises the possibility of providing too much support.[115] We conclude that the reserve price should be the amount of high-cost support that the incumbent LEC would have been entitled to receive had it committed to offer broadband Internet access service within the study area.[116]

37. We set the reserve price in each study area at the incumbent LEC's current level of high-cost support for several reasons. First, we are adopting caps on the overall high-cost fund. Setting a reserve price will help ensure that overall high-cost funding remains within the caps, because the high-cost funding for each Unserved Study Area will merely be transferred to another ETC, not increased. In addition, setting a reserve price at this level will ensure that, even in reverse auctions for particular Unserved Study Areas that do not garner many bids, those bids will be made by providers who are confident that they can assume all the obligations of the carrier of last resort,[117] as well as the new broadband service

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[114] *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

[115] *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

[116] *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 22 n.63 ("The Commission would start bidding at current support levels."). As discussed above, each incumbent LEC ETC's individual high-cost support is frozen at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area basis. *See supra* paras. 16, 30.

[117] Carrier of last resort obligations for incumbent LECs are a matter of state law. Under section 214(e)(6), when the state lacks jurisdiction, the Commission shall make the public interest determination on whether to designate a carrier an ETC. 47 U.S.C. § 214(e)(6).

obligations, and provide service more efficiently than the incumbent LEC.[118] Indeed, we expect that bidders frequently will offer to provide service using newer and more efficient technologies than the incumbent LEC uses today. For these reasons, we set the reserve price at the level described above.

c. Auctioned Support

38. For Unserved Study Areas, we will auction the award of high-cost support to provide all supported services to the entire Unserved Study Area, on a carrier of last resort basis, consistent with the requirements of this order. The maximum annual award amount will be equal to the amount of the winning bid (Award Amount), paid out as described in more detail below as certain geographic areas are built out.[119]

The ETC requirements include a requirement to provide supported services throughout the service area. 47 U.S.C. § 214(e)(1).

[118] Some commenters oppose setting the reserve price at current incumbent LEC levels, or setting any reserve price. *See* OPASTCO *High-Cost Reform NPRMs* Comments at 19-20; MSTC Group *High-Cost Reform NPRMs* Comments at 17-18; North Dakota PSC *High-Cost Reform NPRMs* Comments at 5. We find that setting the reserve price at the incumbent LEC support level will provide certainty to bidders and enable bidders with more efficient technologies to provide broadband in areas where incumbent LECs do not commit to do so. Furthermore, as discussed below, if a reverse auction provides no winner, the Commission will examine the need for further action. *See infra* para. 47.

[119] A competitive ETC that currently serves all or a portion of an Unserved Study Area will not receive high-cost support for the same service area as both a winning bidder and based upon a showing of its own costs. If a competitive ETC that already receives high-cost support within this study area wins the auction, it will lose its existing high-cost support for particular geographic areas as it begins to receive its Award Amount for those areas.

39. The Award Amount is conditioned on the winning bidder providing all supported services as a carrier of last resort, as the incumbent LEC does today under state law, and meeting the ETC requirements set forth in the *ETC Designation Order*.[120] Competitive ETCs are currently required to provide supported services throughout their service area, even though they may not be, under state law, the carrier of last resort.[121] In the *ETC Designation Order*, the Commission adopted additional requirements for ETC designation proceedings in which the Commission acts pursuant to section 214(e)(6).[122] The Commission requires that applicants seeking ETC designation from this Commission demonstrate the following: (1) a commitment and ability to provide services, including providing service to all customers within its proposed service area; (2) that it will remain functional in emergency situations; (3) that it will satisfy consumer protection and service quality standards; (4) that it offers local usage comparable to that offered by the incumbent LEC; and (5) an understanding that it may be required to provide equal access if all other ETCs in the designated service area relinquish their designations pursuant to section 214(e)(4).[123] We find that the universal service obli-

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[120] *ETC Designation Order*, 20 FCC Rcd 6371. Section 214(e)(6) of the Act gives the Commission authority to designate carriers as ETCs when those carriers are not subject to the jurisdiction of a state commission. 47 U.S.C. § 214(e)(6). The requirements in the *ETC Designation Order* currently apply only to Commission-designated ETCs, although the Commission, in that order, encouraged state commissions to adopt similar requirements. *ETC Designation Order*, 20 FCC Rcd at 6372, 6379, paras. 1, 19.

[121] *See* 47 U.S.C. § 214(e)(1).

[122] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20.

[123] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20; 47 U.S.C. § 214(e)(4).

gations in the *ETC Designation Order* will apply to all competitive ETCs winning reverse auctions; in addition, the auction winner must accept all of the carrier of last resort obligations of the incumbent LEC for that study area, whether such obligations are imposed on the LEC pursuant to state or federal law.

40. In addition to the *ETC Designation Order* requirements, we add two additional requirements to competitive ETCs winning reverse auctions. First, they must, as a condition of receiving the Award Amount, offer broadband Internet access service to all customers within the Unserved Study Area. Second, competitive ETCs winning reverse auctions must offer supported services at a retail price comparable to the retail price charged by the incumbent LEC in that same study area for the same or equivalent service.[124] In this manner, we ensure that competitive ETCs receiving high-cost support will continue to make supported services at least as affordable and available as they are today.

41. We recognize that a transition mechanism is needed to shift high-cost support from the incumbent LEC currently receiving it to another ETC that wins an Award Amount. A flash cut would be harmful in at least two ways. First, the incumbent LEC would immediately lose support upon which it may rely to maintain supported services as a carrier of last resort to consumers today. It is possible that removing support from the incumbent LEC would, in some cases, jeopardize its provi-

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[124] In adopting this requirement, we are not setting any specific rates, nor does this requirement conflict with the states' jurisdiction over intrastate rates. Instead, we are conditioning the receipt of federal universal service support on an ETC's provision, on a voluntary basis, of rates comparable to the incumbent LEC's for equivalent services.

sion of services to some users. In addition, granting a full Award Amount immediately to a winning ETC would provide little incentive for the competitive ETC to build out new facilities to difficult-to-serve areas until the last possible moment, as in many cases those areas will be the most expensive to serve. As a result, we conclude that, prior to the initiation of an auction, the incumbent LEC for the Unserved Study Area will be required to identify the distribution of support by geographic area for purposes of the auction and the transfer of support to the winning bidder. As the winning ETC builds out to those geographic areas and certifies that it complies with all its obligations under this order for that area, it will receive high-cost support for that portion of the Unserved Study Area, and the incumbent LEC will no longer receive such support for that area.[126] As the winning bidder takes on carrier of last resort obligations and obtains high-cost support for an area, the incumbent LEC will no longer receive high-cost support for that area and will be relieved of its carrier of last resort obligations at both the state and federal levels. We require winning auction bidders to comply fully with all the requirements of this order by the end of a ten-year build-out period.

42. Finally, we address the question of transferability of the Award Amount. We conclude that auction winners

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[126] The amount of support to be awarded to the winning bidder could be less than the amount of support received by the incumbent LEC for that same area. The transfer of support will be based on the amount of support, relative to support for the entire study area, received by the incumbent LEC for the area to be transferred; that same relative percentage will be used to calculate the amount of award support the auction winner should receive for the same area. In no event will an incumbent LEC who is not an auction winner continue to receive support for an area once an auction winner begins to receive support for that same area.

may transfer their right to the Award Amount. This transfer could take one of several forms—an auction winner could be purchased by another entity, the winner could sell assets used to provide the supported services, or the auction winner could transfer just the right to the Award Amount itself. The transferee will, in all events, step into the shoes of the auction winner and will be responsible for meeting all obligations as if it had been the original auction winner. Any such transfer, however, must be authorized by the Commission before it is consummated.

d. Selecting a Winning Bid

43. In the *Reverse Auctions NPRM*, we sought comment on whether the reverse auction should award high-cost support to a single winner or to multiple winners.[126] We observed that if only one winner receives support, this could provide a fair and efficient means of eliminating the subsidization of multiple ETCs in a region, particularly in areas in which costs are prohibitive.[127] We tentatively concluded that universal service support auctions should award high-cost support to a single winner.[128] We now conclude that the single winner format will provide the most effective mechanism for determining the support amount sufficient to meet the universal service goals in any given area.[129] We therefore adopt our tenta-

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[126] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 13.

[127] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14.

[128] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14

[129] *See, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 4-5; New York PSC *Identical Support and Reverse Auctions NPRMs* Comments at 2-3; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 21-22, App. at 12. We disagree with commenters who support multiple winner auctions. *See, e.g.*, Alltel *High-Cost Reform NPRMs* Comments at 40-41; Atlantic TeleNet-

tive conclusion to select one winner in each reverse auction.

44. As we have explained above, in requiring the offering of broadband Internet access service as a condition of receiving high-cost support, one of our main goals is to ensure that all Americans have access to affordable, quality broadband services.[130] Achieving this goal will require careful selection of the winning bidder for a particular Unserved Study Area. As explained in more detail below, the winning bidder will be the one who commits to offer the highest speed of broadband service—throughout the entire Unserved Study Area—at a bid amount that is equal to or less than the reserve price (the incumbent LEC's current high-cost support amount). In so doing, we work towards making quality, technologically advanced broadband services available to all Americans, including those in difficult- or expensive-to-serve areas, rather than settling for lesser broadband service for those Americans who live in high-cost areas. We acknowledge that, in many cases, the winning bid will not be the cheapest one. But we believe that encouraging bidders to offer better broadband services at or below a set reserve price will help us achieve our broadband goals, while keeping an appropriate limit on the amount of high-cost support disbursed to achieve that goal.

45. For purposes of our reverse auction, we establish three tiers of broadband service. We will use the term "Basic Broadband Tier 1" to refer to service with down-

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work *Identical Support and Reverse Auctions NPRMs* Comments at 13. We find that supporting a single auction winner is a more efficient means of ensuring the provision of broadband Internet access in areas where the incumbent LEC has determined that the costs of serving all customers in the area is prohibitive.

[130] *See supra* paras. 19-23.

load speeds equal to or greater than 768 kbps but less than 1.5 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 2" to refer to service with download speeds equal to or greater than 1.5 mbps and less than 3 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 3" to refer to service with download speeds equal to or greater than 3 mbps, and upload speeds greater than 200 kbps.[131]

46. We will evaluate bids as follows: for any Unserved Study Area, a bidder will submit a bid to commit to offering a service falling within Basic Broadband Tier 1, Broadband Tier 2, or Broadband Tier 3 to all customers in the Unserved Study Area. To qualify for an award, the bid must be equal to or less than the reserve price—that is, equal to or less than the amount of high-cost support received by the incumbent LEC for that Unserved Study Area.[132] The bidder need not specify a specific speed to which it will commit in any of the three tiers, but it must disclose in which tier its proposed service will fall. The bid amount will be an amount of high-cost support to provide all supported services in the Unserved Study Area as carrier of last resort, subject to all the requirements of this order, including the condition to offer broadband throughout the Unserved Study Area. The winning bid will be selected through a two-step process. First, we will identify the highest speed tier for which there is a valid bid. If there is only one bid for that tier, then that is the winning bid. If there are multiple bids

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[131] These terms are similar, but not identical, to terms used in our latest *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700-01, para. 20 & n.66.

[132] *See supra* paras. 16-36.

within that tier, then the winning bid will be the lowest price bid within that tier.[133]

47. If a particular reverse auction produces no winner, the study area will be identified as a truly high-cost study area. The fact that there is no winning bidder may indicate that the reserve price was set at too low an amount of support. The Commission will reexamine any such study area to determine whether the frozen high-cost support amount is sufficient, and, if it is not, the Commission will determine what further actions should be taken to ensure that the study area is served by a provider that will meet the broadband commitment and carrier of last resort requirements. For example, the Commission may consider disaggregating the study area on a wire center basis for reverse auction purposes, or increasing the amount of high-cost support set as the reserve price for the study area.[134] To ensure continued service to customers during the limited period of time in which the Commission examines these issues, the existing incumbent LEC will continue to have all carrier of last resort and ETC obligations, and will continue to receive high-cost support frozen at its current level pending transfer of such support to the winning bidder of the reverse auction.

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[133] For example, assume the Commission conducted a reverse auction for an Unserved Study Area with a reserve price of $5 and received four bids: $1 to offer Basic Broadband Tier 1, $2 to offer Broadband Tier 2, $3 to offer Broadband Tier 3, and $4 to offer Broadband Tier 3. In that scenario, the winning bid amount would be $3 to offer Broadband Tier 3.

[134] *See* Free Press Oct. 24, 2008 *Ex Parte* Letter at 12 (arguing that, if a study area receives no winning bidder in a reverse auction, then the study area should be disaggregated).

e. Bidder Qualifications

48. We adopt a number of conditions that bidders must meet before they can participate in any auction. We adopt these requirements to help ensure that any bidder who wins an auction will be capable of meeting the commitments that flow from being a winning bidder.

49. First, we require that a bidder be an ETC, certified by the Commission or by a state. In the *Reverse Auctions NPRM*, we tentatively concluded that an auction bidder must be an ETC covering the relevant geographic area prior to participating in the auction.[135] We hereby adopt that tentative conclusion. Winning bidders must be designated as ETCs before receiving high-cost support pursuant to sections 214 and 254 of the Act; therefore, requiring bidders to receive this designation prior to participating in an auction entails only a small additional burden. This burden is offset by the potential delay in deploying broadband Internet access service that would result while a non-ETC winning bidder seeks and obtains ETC designation.[136] We note that ETCs are not required to provide all supported services with their own facilities.[137] ETCs may enter into contracts with

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[135] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500-01, para. 12; *see also, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 5; Indiana Util. Reg. Comm'n *High-Cost Reform NPRMs* Comments at 12; MSTC Group *High-Cost Reform NPRMs* Comments at 12; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments, App. at 8.

[136] For this reason, we disagree with commenters who argue that we should not require bidders to be ETCs. *See* GCI *High-Cost Reform NPRMs* Comments at 89; Consumers Union (CU) et al. *High-Cost Reform NPRMs* Reply at 17.

[137] Pursuant to section 214(e)(1)(A) of the Act, a common carrier designated as an ETC must offer the services supported by the federal universal service mechanisms throughout the designated service

other entities to provide some supported services in part or all of the study area.

50. As a general matter, in our spectrum auctions we require an upfront payment to deter frivolous or insincere bidding.[138] In the reverse auctions we adopt today, we are not requiring an upfront payment. Instead, we are requiring participants to demonstrate to the Commission a capability to meet the milestone requirements. This showing will include, for example, evidence of financial resources with which to undertake the construction or upgrading of facilities necessary to offer broadband Internet access service. In addition, in areas where the bidder does not currently offer telecommunications services, we will require the bidder to submit a plan demonstrating the timetable for building the necessary facilities and obtaining any required permits.

5. Competitive Eligible Telecommunications Carriers

51. In the *Identical Support NPRM*, the Commission tentatively concluded that it should eliminate the current identical support rule for competitive ETCs, because the rule bears no relationship to the amount of money competitive ETCs have invested in rural and other high-cost areas of the country.[139] In that notice, the Commission

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area either by using its own facilities or by using a combination of its own facilities and resale of another carrier's services (including the services offered by another ETC). 47 U.S.C. § 214(e)(1)(A).

[138] *See, e.g., Auction of LPTV and TV Translator Digital Companion Channels Scheduled for November 5, 2008*, AU Docket No. 08-22, Public Notice, DA 08-1944, para. 53 (WTB 2008).

[139] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5; *see, e.g.*, Embarq *High-Cost Reform NPRMs* Comments at 10 ("It is logically inconsistent to compensate a carrier for serving 'high-cost' areas when there is no evidence—in the form of cost studies, filings, or model results—that the areas being supported are indeed 'high-cost'

tentatively concluded that a competitive ETC should receive high-cost support based on its own costs, which better reflect real investment in rural and other high-cost areas of the country, and which create greater incentives for investment in those areas.[140] Because a competitive ETC's per-line support is based solely on the per-line support received by the incumbent LEC, rather than its own network investments in an area, the competitive ETC has little incentive to invest in, or expand, its own facilities in areas with low population densities, thereby contravening the Act's universal service goal of improving the access to telecommunications services in rural, insular and high-cost areas.[141] Instead, competitive ETCs have a greater incentive to expand the number of subscribers, particularly those located in the lower-cost parts of high-cost areas, rather than to expand the geographic scope of their networks. As discussed above, the Joint Board recommended elimination of the identical support rule; we agree with the Joint Board and adopt this recommendation and our tentative conclusion.[142]

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for that carrier."); Frontier *High-Cost Reform NPRMs* Comments at 4 (asserting that identical support is merely a subsidy to competitive ETCs, "and there is no basis to tell whether consumers are getting any [u]niversal [s]ervice benefits whatsoever" from subsidizing competitive ETCs in this manner).

[140] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5.

[141] *See* 47 U.S.C. § 254(b)(3); Alabama PSC *High-Cost Reform NPRMs* Comments at 3 ("The identical support rule provides little incentive for ETCs to invest in building their own facilities in rural areas with low population densities because their support currently is based solely on the per-line support received by the incumbent, instead of investment in the network.").

[142] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 5 (recommending elimination of the identical support rule, which "bears little or no relationship to the amount of money

52. For competitive ETCs, we provide a five-year transition, during which their existing support is reduced in equal steps.[143] More specifically, for each competitive ETC, a base-line level of support will be determined based on the total support received by that competitive ETC for the twelve months prior to the effective date of the order. For the twelve months following the effective date of the order, each competitive ETC will receive support equal to 80 percent of its baseline support amount. In year two, each competitive ETC will receive support equal to 60 percent of its baseline support amount. In year three, each competitive ETC will receive support equal to 40 percent of its baseline support amount. In year four, each competitive ETC will receive support equal to 20 percent of its baseline support amount. Finally, in year five, existing high-cost support for competitive ETCs will be eliminated. In the Further Notice we seek comment on an appropriate universal service mechanism (or mechanisms) focused on the deployment and maintenance of advanced mobile wireless services in high-cost and rural areas.

6. Build-Out Milestones and Monitoring, Compliance, and Enforcement

53. We find that a rigorous monitoring, compliance and enforcement program is necessary to ensure that all incumbent LECs and auction winners receiving high-cost

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competitive ETCs have invested in rural and other high-cost areas of the country").

[143] CTIA Oct. 22, 2008 *Ex Parte* Letter at 1. The calculation of support provisions in this Part apply to competitive ETCs that do not receive high-cost support as the result of winning a reverse auction. Support for winning auction bidders, including competitive ETCs, will be based on the bid amount, as discussed above. *See supra* paras 43-47.

support adhere to their obligation to offer broadband Internet access service throughout their supported service areas by the end of their respective build-out periods. We therefore establish build-out requirements to monitor providers' progress toward their build-out commitment. Specifically, and as described in detail below, we require each provider receiving high-cost support to meet specific milestones with regard to broadband deployment in the years preceding completion.

54. *Applicability of Requirements.* As an initial matter, we find that the monitoring, compliance and enforcement requirements we adopt today will apply equally to all recipients of high-cost support that commit to offer broadband Internet access service as a condition of receiving support. Consumers should expect to receive the benefits of today's order, irrespective of whether an incumbent LEC or winning auction bidder receives high-cost support in their area. We find that the milestone obligations we impose today will not unduly burden any company; rather, they represent efforts we believe carriers would undertake in the normal course of constructing a broadband network. We therefore apply the monitoring, compliance, and enforcement requirements below to all incumbent LECs and auction winners that receive high-cost support.

55. *Milestones for Committed Incumbent LECs* To ensure that incumbent LECs that commit to offering broadband make steady progress towards offering broadband Internet access service throughout their entire service areas as required in this order, we adopt milestones based on customer locations where the incumbent LEC is not yet offering broadband Internet ac-

cess service (Unserved Customers).[144] Specifically, we require incumbent LECs to be capable of providing broadband Internet access service to an additional 20 percent of their Unserved Customers by the end of each year of the five-year build-out period. This requirement means that, of the total number of Unserved Customers in the service area, these carriers must offer broadband to 20 percent by the end of year one, 40 percent by the end of year two, 60 percent by the end of year three, 80 percent by the end of year four, and 100 percent by the end of year five. This five-year period starts from the due date of the incumbent LEC commitment.

56. *Milestones for Auction Winners.* To ensure that auction winners make good progress toward meeting their obligation to become fully compliant with the requirements of this order, we require every auction winner to be capable of serving 10 percent of the potential customers in the service area by the end of year two, 25 percent by the end of year three, 50 percent by the end of year four, 65 percent by the end of year five, 75 percent by the end of year six, 85 percent by the end of year seven, 90 percent by the end of year eight, 95 percent by the end of year nine, 100 percent by the end of year ten. The absence of a milestone at the end of year one is intended to allow new service providers sufficient time to plan their network and to start deploying and marketing it within some parts of the service area. Similarly, the ascending milestones in the remaining years are intended to permit the auction winner a reasonable time in which to build its network and services while ensuring that it does not delay in reaching customers who need this vital

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[144] Customer locations include both residential and business locations within the ETC's service area.

service. The ten-year build-out period starts on the date on which that carrier wins the auction.

57. *Consequences of Not Meeting Milestones.* For all incumbent LECs and auction winners receiving high-cost support, failure to achieve any milestone will result in loss of eligibility for support (and, where this Commission has jurisdiction over the designation of ETC status, loss of ETC status) for that service area. If the incumbent LEC or auction winner loses its eligibility for support, the study area will be subject to re-auction. If at the end of the build-out period, the incumbent LEC or auction winner is not fully compliant with all its obligations under this order, including its obligation to offer broadband Internet service throughout the service area, it will forfeit its eligibility for support and, if its ETC designation was made by this Commission, lose its ETC status.

58. *Milestone Audits.* All milestone data will be subject to audit by the Commission's Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the build-out requirements, the Act, and Commission rules and orders.[145] Service providers will be required to com-

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[145] *See Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-Up, Changes to the Board of Directors for the National Exchange Carrier Association, Inc.*, WC Docket No. 03-109, Report and Order, 22 FCC Rcd 16372, 16383-84, para. 24 (*Comprehensive Review Report and Order*) (requiring "recipients of universal service support for high-cost providers to retain all records that they may require to demonstrate to auditors that the support they received was consistent with the Act and the Commission's rules, assuming that the audits are conducted within five years of disbursement of such support."). The term "service provider" includes any participating subcontractors.

ply fully with the Office of Inspector General's audit requirements, including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of the service providers and their employees, contractors, and other agents, in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this program.[146] Such audits or investigations may provide information showing that a service provider failed to comply with the Act or the Commission's rules, and thus may reveal instances in which universal service support was improperly distributed or used.

59. We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the high-cost program and to determine on a case-by-case basis whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[147]

III. BROADBAND FOR LIFELINE/LINK UP CUSTOMERS

60. In this Part, pursuant to section 254(b) of the Act, we establish a Broadband Lifeline/Link Up Pilot Program (Pilot Program) to examine how the Lifeline and

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[146] This includes presenting personnel to testify, under oath, at a deposition if requested by of the Office of Inspector General.

[147] *See, e.g.*, 41 U.S.C. §§ 51-58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

Link Up universal service support mechanism can be used to enhance access to broadband Internet access services for low-income Americans.[148] Specifically, we conclude that we will make available $300 million each year for the next three years to enable ETCs to support broadband Internet access service and the necessary access devices. In particular, if an ETC provides Lifeline service to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access installation, including a broadband Internet access device, up to a total amount of $100. In addition, if an ETC provides Lifeline service to an eligible household, the Pilot Program will double, up to an additional $10, the household's current monthly subsidy to offset the cost of broadband Internet access service.

A. Background

61. Since 1985, the Commission, pursuant to its general authority under sections 1, 4(i), 201, and 205 of the Act and in cooperation with state regulators and local telephone companies, has administered two programs designed to increase subscribership by reducing charges

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[148] The Commission has established a similar universal service pilot program under the Rural Health Care support mechanism. *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111 (2006) (*2006 Rural Health Care Pilot Program Order*) (establishing a Rural Health Care pilot program to examine how the Rural Health Care funding mechanism can be used to enhance public and non-profit health care providers' access to advanced telecommunications and information services); *Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 22 FCC Rcd 20,360 (2007) (selecting Rural Health Care pilot program participants eligible to receive up to 85% of the costs associated with the construction of state or regional broadband health care networks and with the advanced telecommunications and information services provided over those networks).

to low-income consumers.[149] The Commission's Lifeline program reduces qualifying consumers' monthly charges, and Link Up provides federal support to reduce eligible consumers' initial connection charges by up to one half.[150]

62. Under the Commission's current rules, states and territories have the authority to establish their own Lifeline/Link Up programs that provide additional support to low-income consumers that incorporate the unique characteristics of each state or territory.[151] For example, in establishing eligibility criteria, states have the flexibility to consider federal and state-specific public assistance programs with high rates of participation among low-income consumers in the state. State certification proce-

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[149] 47 U.S.C. §§ 151, 154(i), 201, 205.

[150] Lifeline currently provides low-income consumers with discounts of up to $10.00 off of the monthly cost of telephone service for a single telephone line in their principal residence, though this amount adjusts, in part, to reflect the carrier's tariffed federal subscriber line charge. *See* 47 C.F.R. § 54.403. Link Up provides low-income consumers with discounts of up to $30.00 off of the initial costs of installing telephone service. *See* 47 C.F.R. § 54.411(a). Under the Commission's rules, there are four tiers of federal Lifeline support. All eligible subscribers receive Tier 1 support which provides a discount equal to the ETC's subscriber line charge. Tier 2 support provides an additional $1.75 per month in federal support, available if all relevant state regulatory authorities approve such a reduction. (All fifty states have approved this reduction.) Tier 3 of federal support provides one half of the subscriber's state Lifeline support, up to a maximum of $1.75. Only subscribers residing in a state that has established its own Lifeline/Link Up program may receive Tier 3 support, assuming that the ETC has all necessary approvals to pass on the full amount of this total support in discounts to subscribers. Tier 4 support provides eligible subscribers living on tribal lands up to an additional $25 per month towards reducing basic local service rates, but this discount cannot bring the subscriber's cost for basic local service to less than $1. *See* 47 C.F.R. § 54.403.

[151] *See* 47 C.F.R. §§ 54.409(a), 54.415(a).

dures and outreach efforts can also take into account existing state laws and budgetary limits. Some states and territories, however, have elected to use the federal criteria as their default standard. These "federal default states" include not only states and territories with their own Lifeline/Link Up programs that have adopted the federal default criteria, but also states and territories that have not adopted their own Lifeline/Link Up program. In April 2004, the Commission released an order expanding the federal default eligibility criteria to include an income-based criterion and additional means-tested programs.[152]

63. *Eligibility for Lifeline and Link Up.* In states that provide state Lifeline and Link Up support, Lifeline and Link Up are available to all subscribers who meet state eligibility requirements. Although states have some latitude in selecting means tests, state commissions must establish narrowly targeted qualification criteria that are based solely on income or factors directly related to income for low-income residents to be eligible for Lifeline and Link Up. In addition, states with eligible residents of tribal lands must ensure that their qualification criteria are reasonably designed to apply to residents of tribal lands, if applicable.[153] To receive Lifeline and Link Up in a state that does not mandate state Lifeline support, consumers must certify that their household income is at or below 135 percent of the Federal Poverty Guidelines, or that they participate in one of the following seven federal programs: Medicaid, Food Stamps, Supplemental Security Income (SSI), Federal Public Hous-

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[152] *See Lifeline and Link Up*, WC Docket No. 03-109, Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd 8302 (2004).

[153] 47 C.F.R. § 54.409(a).

ing Assistance (Section 8), the Low-Income Home Energy Assistance Program (LIHEAP), the National School Lunch Program's free lunch program, or Temporary Assistance for Needy Families (TANF).[154] Subscribers living on tribal lands qualify to receive federal Lifeline support if: (1) they qualify under state criteria in a state that provides Lifeline support; (2) they certify that their household income is at or below 135 percent of the Federal Poverty Guidelines; (3) they certify that they receive benefits from one of the seven federal programs listed above; or (4) they certify that they participate in one of the following additional federal assistance programs: Bureau of Indian Affairs General Assistance (GA), Tribally administered Temporary Assistance for Needy Families (Tribal TANF), or Head Start (meeting the income-qualifying standard).[155]

64. *TracFone and Computer and Communications Industry Association Petitions.* On October 9, 2008, TracFone Wireless, Inc. (TracFone) submitted a petition requesting that the Commission establish a trial basis program to support broadband Internet access service and the devices that support this service.[156] Citing data demonstrating that a significant amount of low-income families are unable to afford broadband Internet access, TracFone proposes that the Commission, on a temporary basis, provide affordable access to low-income consumers by supporting broadband Internet access service and the

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[154] 47 C.F.R. § 54.409(b).

[155] 47 C.F.R. § 54.409(a)-(d).

[156] *See Lifeline and Link Up, Federal-State Joint Board on Universal Service*, WC Docket No. 03-109, CC Docket No. 96-45, Petition to Establish A Trial Broadband Lifeline/Link Up Program (filed Oct. 9, 2008) (*TracFone Petition*).

devices used to access these services.[157] TracFone proposes limiting the program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee, and the District of Columbia.[158] Doing so, according to TracFone, will enable to the Commission to examine how to better make available broadband Internet access service to low-income consumers throughout the Nation.[159]

65. On October 7, 2008, the Computer and Communications Industry Association (CCIA) filed a petition requesting the Commission revise the definition of universal service supported services to allow low-income consumers receive support for broadband Internet access services.[160] CCIA states that, despite a critical need for broadband Internet access service, low-income consumers still have a considerably low broadband Internet access deployment rate. Accordingly, CCIA argues the definition of supported services for purposes of universal service should be revised to provide support for broadband Internet access service to low-income consumers.[161]

76. In recent proceedings, other parties have also urged the Commission to provide low-income consumers with support for broadband services. For example, Windstream argues that the Commission should direct broadband support to low-income consumers where such

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[157] *See TracFone Petition* at 3-4.

[158] *See TracFone Petition* at 3.

[159] *See TracFone Petition* at 5.

[160] *See* Petition for Rulemaking to Enable Low-Income Consumers to Access Broadband Through the Universal Service Lifeline and Link Up Programs, WC Docket No. 03-109 (filed Oct. 7, 2008) (*CCIA Petition*).

[161] *See CCIA Petition* at 7.

support is most needed.[162] AARP also concludes that the Commission should provide Lifeline/Link Up support for broadband services and urges the Commission to conduct a proceeding to examine the matter.[163] AARP proposes that in addition to examining supporting broadband services, the Commission should also examine how to increase low-income consumers' access to devices that support broadband services and education on how to use such devices.[164] Many consumer groups and service providers have also commented in support of TracFone and CCIA's proposals to support the provision to low-income consumers of broadband Internet access service and the devices used to access these services.[165]

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[162] *See* Letter from Eric Einhorn, Vice President Governmental Affairs, Windstream Communications Inc., to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 99-68, 08-122, 05-337, 08-152 (Sept. 24, 2008) (Windstream Sept. 24, 2008 *Ex Parte* Letter).

[163] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

[164] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

[165] *See, e.g.*, Letter from Dale R. Schmick, CEO, YourTel America, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 03-109, 05-337, at 2 (filed Oct. 21, 2008) (YourTel Oct. 21, 2008 *Ex Parte* Letter); Letter from Thomas J. Sugrue, Vice President Government Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket Nos. 04-356, 07-195 at 3 (filed Oct. 17, 2008) (urging the Commission to adopt quickly TracFone's and CCIA's proposals); Letter from Karyne Jones, President & CEO, National Caucus and Center on Black Aged, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 at 1 (filed Oct. 29, 2008) (NCBA Oct. 29, 2008 *Ex Parte* Letter); Letter from Donnie Ruby, Staff Associate, Telecommunications Research and Action Center, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008); Letter from Bill

B. Discussion

67. Consistent with the Commission's authority under sections 1, 4(i), 201, 205, and 254 of the Act, we establish a Lifeline and Link Up pilot program to support the provision of broadband Internet access service and the devices used to access this service to low-income consumers.[166] In doing so, we explain the justification for estab-

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Newton, Executive Director, Florida Consumer Action Network, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 27, 2008); Letter from Robert D. Atkinson, Chair Public Policy Committee, Alliance for Public Technology, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 24, 2008) (APT Oct. 24, 2008 *Ex Parte* Letter); Letter from John Breyault, Vice President of Public Policy Telecommunications and Fraud, National Consumers League, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 23, 2008) (NCL Oct. 23, 2008 *Ex Parte* Letter); Letter from Mark Richert, Director, Public Policy, American Foundation for the Blind, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008) (AFB Oct. 28, 2008 *Ex Parte* Letter).

[166] To the extent that our adoption of the Pilot Program adds broadband to the list of universal service supported services, we clarify that this inclusion is limited only to the Pilot Program—broadband is not a supported service for other low-income or high-cost support purposes. Pursuant to section 254(c)(1) of the Act, the Joint Board has recommended adding broadband as a supported service, and we do so for the limited purpose of the Pilot Program. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 4 ("The Joint Board now recommends that the nation's communications goals include achieving . . . universal availability of broadband Internet services"). Furthermore, the Commission's authority to provide universal service support to low-income consumers predates the adoption in 1996 of section 254 of the Act, and arises out of sections 1, 4(i), 201, and 205 of the Act. 47 U.S.C. §§ 151, 154, 201, 205; *Universal Service First Report and Order*, 12 FCC Rcd at 8956-57, paras. 338-40. Pursuant to our authority to regulate low-income support under these sections, as well as under section 254, we pro-

lishing this program and provide criteria and obligations applicants must satisfy for selection to participate in this program. Further, we establish requirements for oversight and administration of the Pilot Program.

68. *Broadband Internet Access Service and Devices Eligible for Low Income Support.* In the *Universal Service First Report and Order*, consistent with its statutory obligations, the Commission maintained the authority to adopt changes to the Lifeline program to make it more consistent with Congress's mandates in the 1996 Act if such changes would serve the public interest.[167] We believe that a Lifeline and Link Up pilot program comports with the goals of universal service, and advances the public interest by providing new technologies and services to low-income consumers. Section 254(b)(2) of the Act instructs the Commission to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[168] Similarly, section 254(b)(3) states that "low-income consumers . . . should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[169]

69. Since the Commission first adopted its universal service rules in response to the 1996 Act, broadband

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vide universal service support for broadband Internet access services through the Pilot Program.

[167] *Universal Service First Report and Order*, 12 FCC Rcd at 8956, para. 339.

[168] 47 U.S.C. § 254(b)(2) (emphasis added).

[169] *See* 47 U.S.C. § 254(b)(3) (emphasis added).

Internet access service has evolved into a critical service for American consumers.[170] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and many other uses. Access to broadband Internet access service is especially important to low-income consumers for purposes of education, public health and public safety.[171] High-speed connections to the Internet allow children in low-income families access to distance learning and research.[172] Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare to low-income families living in areas that may lack access to the breadth of medical expertise and advanced medical technologies available in

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[170] *See* APT Oct. 24, 2008 *Ex Parte* Letter at 2; NCBA Oct. 29, 2008 *Ex Parte* Letter at 1; NCL Oct. 23, 2008 *Ex Parte* Letter at 1.

[171] According to the National Caucus and Center on Black Aged, older low-income Americans have difficulty affording broadband services and many do not have Internet access. NCBA Oct. 29, 2008 *Ex Parte* Letter at 1 (citing Older Americans, Broadband and the Future of the Net, SeniorNet, 2008). Commenters also assert that broadband connections are particularly necessary for consumers who are blind, visually impaired, deaf or hard of hearing. *See* APT Oct. 24, 2008 *Ex Parte* Letter at 1 (citing ALLIANCE FOR PUBLIC TECHNOLOGY, ACHIEVING UNIVERSAL BROADBAND: POLICIES FOR STIMULATING DEPLOYMENT AND DEMAND 27 (2007)); AFB Oct. 28, 2008 *Ex Parte* Letter.

[172] *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, GN Docket No. 07-45, Notice of Inquiry, 22 FCC Rcd 7816, 7817, para. 3 (2007) (*706 Fifth NOI*).

other areas.[173] Broadband Internet access service also enables the sharing of critical, time-sensitive information with first responders, government officials, and health care providers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis.

70. Despite the advances in broadband technology, broadband availability still lags for low-income consumers.[174] The Commission's most recent data reveal that where the median income is under $21,000, approximately 99.5 percent of households have high-speed service available with speeds in excess of 200 kbps in at least one direction.[175] Yet, according to the Pew Internet & American Life Project, only 25 percent of households with annual incomes below $20,000 have broadband service.[176] In contrast, among those living in households with annual incomes in excess of $100,000, broadband adoption is approximately 85 percent.[177]

71. According to the Commission's data, there are approximately 6.9 million consumers participating in the Lifeline universal service program.[178] Providing an additional $300 million in annual support through the low-income universal service support mechanisms over a three-year period should increase the broadband sub-

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[173] *See 2006 Rural Health Care Pilot Program Order*, 21 FCC Rcd at 11112, para. 5; *706 Fifth NOI*, 22 FCC Rcd at 7817, para. 4.

[174] *See* Cellular South *High-Cost Reform NPRMs* Comments at 10.

[175] *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl. 19 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-277784A1.pdf.

[176] *See* 2008 PEW BROADBAND ADOPTION STUDY ii.

[177] *See* 2008 PEW BROADBAND ADOPTION STUDY at 2.

[178] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT.

scribership for low-income customers to over fifty percent.[179]

72. We therefore find that this Pilot Program furthers the universal service objectives of section 254 of the Act and serves the public interest by making this critical service available to the low-income Americans who cannot otherwise afford it. In addition, the Pilot Program will provide the Commission with a more complete and practical understanding of how to ensure the best use of Lifeline and Link Up universal service support to deploy advanced services to low-income consumers.[180]

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[179] Desktop computers can be purchased for as low as $200. *See* Walmart Consumer Products, http://www.walmart.com/catalog/catalog.gsp?cat=3951&fromPageCatId=14503 (last visited Oct. 24, 2008). For $267, a consumer can purchase a new ASUS Eee PC 2G Surf laptop. *See* Amazon ASUS Eee PC 2G Surf Product Page, http://www.amazon.com/gp/product/B00114T9WY/ref=noref?ie=UTF8&s=pc (last visited Oct. 24, 2008). Personal computers and wireless devices will continue to become *available at* even lower rates. Throughout the world, there are $100 laptops and wireless devices. *See* Michael Trucano, InfoDev.org, Quick guide: Low-cost computing devices and initiatives for developing world (Apr. 2008), http://www.infodev.org/en/Publication.107.html (last visited Oct. 25, 2008). For example, Candlebox, being developed for use in India by Qualcom, is a low-cost, low-power device that uses mobile technology to provide wireless Internet access and supports e-mail, social networking, e-commerce and distance learning applications. RICHARD P. ADLER & MAHESH UPPAL, ASPEN INSTITUTE INDIA, M-POWERING INDIA: MOBILE COMMUNICATIONS FOR INCLUSIVE GROWTH at 21 (2008), *available at* http://www.aspeninstitute.org/atf/cf/%7Bdeb6f227-659b-4ec8-8f84-8df23ca704f5%7D/2008INDIA.pdf.

[180] *See* NCBA Oct. 29, 2008 *Ex Parte* Letter at 2 (suggesting that the Pilot Program should be modeled after the existing Lifeline program and can be studied and evaluated to develop future broadband Lifeline/Link Up support programs).

1. Available Funding

73. We establish a maximum annual funding level for this broadband Lifeline and Link Up Pilot Program at $300 million for each of the next three years. In its petition, TracFone proposes that a pilot program should fund up to either $180 million or $360 million per year for Lifeline broadband Internet access service support, and up to $125 million or $250 million for the Link Up portion of the program, for a total of either $305 million or $610 million, depending on whether the program would support 500,000 participants or one million participants.[181]

74. While we recognize the importance of making sufficient funds available for this Pilot Program to enable us to determine whether and, if so, how to make broadband Internet access service funding a permanent part of the Lifeline and Link Up programs, we find that the levels of funding proposed by TracFone are not sufficiently tied to a specific improvement in the adoption of broadband by Lifeline subscribers, as discussed above. In 2007, the overall size of the universal service fund's disbursement mechanisms was approximately $7.0 billion.[182] Of that amount, approximately $823 million went to fund the universal service low-income program.[183] TracFone's proposal represents a potential 74 percent increase over existing low-income program disbursements, and would be limited to targeting low-income consumers in only three states and the District of Columbia.[184] We are concerned that such a large funding commitment for a limited geo-

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[181] *See TracFone Petition* at 5.

[182] *See* USAC 2007 ANNUAL REPORT at 51. USAC's administrative expenses for 2007 were $104,073,000. *Id.* at 3.

[183] USAC 2007 ANNUAL REPORT at 3.

[184] *See TracFone Petition* at 3.

graphic area would not provide the Commission with sufficient information to assess the benefits of expanding the low-income support mechanisms upon the conclusion of the Pilot Program. When extrapolated to all states and territories, the low-income pilot program proposed by TracFone could potentially double the size of the $7 billion universal service fund.[185] We find it more appropriate to fund a pilot program that better correlates with providing broadband Internet access service to all eligible low-income support recipients as this provides better information regarding the permanent adoption of such support.

75. Instead, we set the size of the Lifeline and Link Up Pilot Program at up to $300 million per year over the next three years. We find that this amount provides benefits to low-income consumers while not overly increasing the amount of low-income support disbursed from the universal service fund. Specifically, this level of funding should enable the program to increase the broadband subscribership for these customers to over fifty percent.[186]

2. Eligible Services and Equipment

76. For the broadband Lifeline/Link Up Pilot Program we adopt today, we limit support to one subsidy per household. For purposes of this order, we define "household" as one adult and his/her dependants, living together in the same residence.[187] Participating households

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[185] Assuming $250 is provided to each consumer, the total cost of the TracFone proposal could reach almost $7 billion.

[186] *See supra* para. 71.

[187] *Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-up*, CC Docket Nos. 96-45, 02-6 and WC Docket Nos. 02-60, 03-109, Order, 20 FCC Rcd

who remain eligible for the program will be entitled to remain in the program beyond the first year, subject to the requirement that participating ETCs verify their customers' continued eligibility under the applicable income-based or program-based criteria, as they are required to do for their current voice Lifeline customers. We do not require state or carrier matching requirements. The Pilot Program is exempt from fees and taxes to the same degree as the current Lifeline programs.

77. Under the Link Up portion of the Pilot Program we adopt today, we seek to overcome barriers that low-income households might face in subscribing to broadband services, such as lacking the equipment necessary to connect to broadband services. Therefore, if an ETC currently provides or seeks to provide Lifeline voice service to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access service installation, including a broadband Internet access device, up to a total amount of $100. The device can be a laptop computer, a desktop computer, or a handheld device, so long as the equipment has the capability to access the Internet at the speeds established per this order, and the equipment carries at least a warranty.[188] The device subsidy is a one-time subsidy and is limited to one unit per qualified household.[189] The subsidy amount will be paid by USAC to the participating ETC that provides the device and the service to the customer, utilizing the

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16883, 16890, para. 12 (2005) (*Hurricane Katrina Order*). Also, service agreements of longer than the lesser of one year or the remaining Pilot Program funding period are prohibited.

[188] Where such device costs $100 or less, the Pilot Program will support 90% of the cost of the broadband Internet access device.

[189] 47 C.F.R. § 54.411(b).

same process that USAC uses for the current Link Up program.[190]

78. Once low-income households have the ability to connect to the Internet, we seek to ensure that they can afford to subscribe to broadband Internet access service. Under the Lifeline portion of the program, if an ETC currently provides or seeks to provide Lifeline voice service to an eligible household, and that ETC provides broadband Internet access service, the Pilot Program will double the current monthly subsidy for the Lifeline subscriber up to $10 per month to offset the cost of broadband Internet access service.[191] As defined in this order, broadband Internet access service is an "always on" service that combines computer processing, information provision, and computer interactivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed below.[192] This monthly support provided to participating customers under the Pilot Program is separate from and in addition to their monthly Lifeline support for voice telephone service.[193]

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[190] *See* USAC, Low Income: Overview of the Process, http://www.universalservice.org/li/about/overview process.aspx (last visited Oct. 11, 2008).

[191] Because $10 is the maximum federal support under Tier 1 to Tier 3 of the existing Lifeline program, we find this to be the appropriate support amount for purposes of the Pilot Program. *See* 2007 UNIVERSAL SERVICE MONITORING REPORT, tbl. 2.3. Ten dollars is also above the average Lifeline support amount of $8.46, which includes both tribal and non-tribal recipients. *See id.*, tbl. 2.12.

[192] *See infra* para. 84.

[193] Pilot Program participants may not receive support for the same services from both the Pilot Program and the existing universal service programs – which consist of the rural health care, E-rate, high-cost, and low-income programs.

79. All ETCs participating in the existing low income programs are eligible to participate, provided that they notify the Commission and USAC of their election to participate at least a month in advance and certify that they will comply with all program requirements, including those set forth herein. Such certification must identify the service area in which the ETC plans to offer such Lifeline/Link Up broadband services, the costs of such service and broadband device, and all costs, both recurring and nonrecurring, to the customer participating in the program. The ETC must offer the services supported in the Pilot Program throughout the entire service area. The Wireline Competition Bureau will release a public notice establishing a deadline by which ETCs must notify the Commission of their intention to participate.

80. The program we adopt today is technologically and competitively neutral; however, we establish minimum speeds at which participating ETCs must be able to provide broadband service. ETCs participating in the Pilot Program must offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[194]

3. Selection Criteria

81. TracFone suggests that all ETCs notifying the Commission of their intent to participate in the Pilot Program should be allowed to provide the broadband Internet access service and devices under the Pilot Program.[195] TracFone also argues that the Commission should limit the Pilot Program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee and

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[194] *See supra* para. 28.

[195] *TracFone Petition* at 4.

the District of Columbia.[196] We agree with TracFone that all ETCs should be allowed to provide services under the Pilot Program, but we disagree that the consumers who are eligible to participate should be limited to three states and the District of Columbia.[197] Instead, it is consistent with the public interest to allow all ETCs and consumers that meet the criteria discussed in this order to participate in the Pilot Program, limited only by the availability of funds. Support will be disbursed on a "first come, first served basis" where priority is established according to ETCs' submission of reimbursement requests to USAC and compliance with program eligibility.

82. *Consumer Qualifications.* To receive reimbursement under the Pilot Program, an ETC must provide support to a consumer eligible for support under the current Lifeline and Link Up programs. Specifically, the consumer must meet the eligibility criteria specified in section 54.409 of the Commission's rules.[198] We agree with TracFone that only one connection and device per household should be funded. Accordingly, we limit Pilot Program support to one new connection and device per household. Lifeline consumers who currently have a broadband connection and related Internet device are excluded from participation in this Pilot Program. In addition to their obligations under section 54.409 of our rules, consumers must demonstrate that they do not cur-

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[196] *TracFone Petition* at 3.

[197] *See, e.g.*, YourTel Oct. 21, 2008 *Ex Parte* Letter at 2 (urging the Commission to allow low-income consumers living in Missouri to be eligible for Pilot Program support).

[198] *See* 47 C.F.R. § 54.409.

rently have a broadband Internet access service subscription or broadband Internet access device.[199]

83. *ETC Obligation to Offer Pilot Program Services.* Prior to participation, ETCs must notify the Commission and USAC of their intention to participate. A participating ETC must offer the services and supported devices to all qualifying low-income consumers throughout its service areas. It must also follow the carrier obligations identified in section 54.405, as applicable, of the Commission's rules.[200] Consumers and ETCs must follow the framework and requirements of the existing Lifeline and Link Up program.[201]

4. Implementation and Reporting Requirements

84. To be eligible for support, ETCs must submit a reimbursement request to USAC 30 days from the date a customer subscribes to service or purchases a device. We require participating each ETC to file with USAC on a monthly basis the number of Pilot Program consumers it is serving, the types and prices of devices offered, the type of technology used (including make and model of equipment used) and the speeds at which it is providing service to each of those consumers. ETCs in their monthly submission must also report the number of subscribers served for the past month and projections for the number of subscribers for the next 2 months. Such monthly reporting is required to allow USAC to monitor

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[199] As discussed above, for purposes of this Pilot Program we define "household" as one adult and his/her dependants living together in the same residence. *See supra* para 76; *Hurricane Katrina Order*, 20 FCC Rcd at 16890, para. 12.

[200] *See* 47 C.F.R. § 54.405.

[201] 47 C.F.R. § 54.400-.417.

availability of funds under the Pilot Program and notify participating ETCs when funds may no longer be available for additional customers. In determining and/or projecting funds availability, USAC should consider the recurring costs of existing customers; we decline to specifically allocate the available funding between Lifeline and Link Up, relying instead on the certification and reporting requirements herein to enable USAC to properly administer the Pilot Program.

85. Similar to current recordkeeping requirements, we also require ETCs to maintain records to document compliance with all Commission requirements governing this Pilot Program for the three full preceding calendar years and provide that documentation to the Commission or USAC upon request.[202] Additionally, ETCs must maintain documentation for as long as the consumer is receiving broadband Lifeline service from that ETC pursuant to the Pilot Program, and for three additional years after the consumer stops receiving service pursuant to the Pilot Program.

86. ETCs may receive reimbursement for the revenue they forego in reducing the price of any qualified consumers' broadband Internet access service and related device. As a condition of participation, it is the ETC's responsibility to make available a wide array of cost efficient broadband Internet access devices capable of providing the speeds described above to qualified consumers under this program. ETCs must also comply with the self-certification procedures, and submit certifications with their monthly submissions, consistent with sections 54.410 and 54.416 of the Commission's rules.[203]

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[202] *See* 47 C.F.R. § 54.417(a).

[203] *See* 47 C.F.R. §§ 54.410, 54.416.

Any services or equipment supported under this order are non-transferable and the devices must be returned to the ETC if they are not used in compliance with the terms of this order or other applicable laws or regulations. We delegate to the Wireline Competition Bureau the authority to disqualify an ETC or consumer from the Pilot Program and seek recovery of support not used in a manner consistent with this order.

5. Program Oversight

87. We are committed to guarding against waste, fraud, and abuse, and ensuring that funds disbursed through the Pilot Program are used for appropriate purposes. In particular, each Pilot Program participant shall be subject to audit by the Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the Pilot Program, Commission rules and orders, as well as section 254 of the Act.[204] The Pilot Program participant will be required to comply fully with the Office of Inspector General's audit requirements including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of itself and its employees, contractors, and other agents in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this Pilot Program.[205] Such audits or investigations may provide information showing that a Pilot Program participant or vendor failed to comply with the Act or the Commission rules, and thus may reveal instances in which Pilot Program awards were improperly distributed

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[204] *See* 47 C.F.R. § 54.619; *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 26.

[205] This includes presenting personnel to testify, under oath, at a deposition if requested by the Office of Inspector General.

or used. To the extent the Commission finds that funds were distributed and/or used improperly, the Commission will require USAC to recover such funds though its normal processes, including adjustment of support amounts in other universal service programs from which Pilot Program participants receive support.[206] If any participant fails to comply with Commission rules or orders, or fails to timely submit filings required by such rules or orders, the Commission also has the authority to assess forfeitures for violations of such Commission rules and orders. In addition, any participant or service provider that willfully makes a false statement can be punished by fine or forfeiture under sections 502 and 503 of the Act,[207] or by fine or imprisonment under Title 18 of the United States Code (U.S.C.) including, but not limited to, criminal prosecution pursuant to section 1001 of Title 18 of the U.S.C.[208] We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the Pilot Program and to determine on a case-by-case basis

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[206] We intend that funds disbursed in violation of a Commission rule that implements section 254 or a substantive program goal will be recovered. Sanctions, including enforcement action, are appropriate in cases of waste, fraud, and abuse, but not in cases of clerical or ministerial errors. *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16388-89, para. 30.

[207] 47 U.S.C. §§ 502, 503(b).

[208] 18 U.S.C. § 1001. Further, the Commission has found that "debarment of applicants, service providers, consultants, or others who have defrauded the USF is necessary to protect the integrity of the universal service programs." *Comprehensive Review Report and Order*, 22 FCC at 16390, para. 32. Therefore, the Commission intends to suspend and debar parties from the Pilot Program who are convicted of or held civilly liable for the commission or attempted commission of fraud and similar offenses arising out of their participation in the Pilot Program or other universal service programs. *See id.* paras. 31-32.

whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[209] The Commission will also monitor the use of awarded monies and develop rules and processes as necessary to ensure that funds are used in a manner consistent with the goals of this Pilot Program. Finally, we remind participants that nothing in this order relieves them of their obligations to comply with other applicable federal laws and regulations.

IV. REFORM OF UNIVERSAL SERVICE CONTRIBUTIONS

88. In this Part, we adopt a telephone numbers-based methodology under which contributors will pay a constant, flat-rate assessment based on the number of telephone numbers they have assigned to residential end users. We set this per-number assessment at the fixed rate of $1.00 per residential number per month. We conclude that providers of business services should contribute to the universal service fund on a connection basis, and we seek comment on implementation of that methodology. In the interim, providers of business services will continue to contribute based on interstate and international revenues for these services. The separate contribution methodologies for residential and business services will be implemented beginning on January 1, 2010.

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[209] *See, e.g.*, 41 U.S.C. §§ 51-58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

A. Background

89. In implementing the universal service requirements of the 1996 Act, the Commission established a method for collecting funds to be disbursed through the various universal service support mechanisms. Specifically, the Commission determined that contributions to the universal service fund would be assessed on telecommunications providers based on their interstate and international end-user telecommunications revenues.[210] The Commission concluded that basing providers' universal service contributions on their revenues would be competitively neutral, easy to administer, and explicit.[211]

90. When the Commission adopted the revenue-based contribution system, assessable interstate revenues were growing. The total assessable revenue base has declined in recent years, however, from about $79.0 billion in 2000 to about $74.5 billion in 2006,[212] while universal service

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[210] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206-07, paras. 843-44; *Federal-State Joint Board on Universal Service; Access Charge Reform*, Sixteenth Order on Reconsideration and Eighth Report and Order in CC Docket No. 96-45 and Sixth Report and Order in CC Docket No. 96-262, 15 FCC Rcd 1679, 1685, para. 15 (1999) (*Fifth Circuit Remand Order*) (establishing a single contribution for all universal service support mechanisms based on interstate and international revenues).

[211] *Universal Service First Report and Order*, 12 FCC Rcd at 9206-08, 9211, paras. 843, 845-48, 854.

[212] *Compare* JIM LANDE & KENNETH LYNCH, FCC, 2000 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2002), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/telrev00.pdf *with* JIM LANDE & KENNETH LYNCH, FCC, 2006 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284929A1.pdf. *But see* Letter from David C. Bergmann, Chair, NASUCA Telecommunications Committee, to Chairman Kevin Martin et al., FCC, WC Docket Nos. 08-152, 07-135, 06-122, 05-337, 05-

disbursements grew over that same time period from approximately $4.5 billion in 2000 to over $6.6 billion in 2006.[213] Declines in assessable contribution revenues combined with growth in universal service disbursements have increased the contribution factor applied to determine universal service contribution amounts.[214] This upward pressure jeopardizes the stability and sustainability of the support mechanisms, demonstrating the need for long-term fundamental reform of the contribution methodology.[215]

91. In addition, interstate end-user telecommunications service revenues are becoming increasingly difficult to identify as customers migrate to bundled packages of interstate and intrastate telecommunications and

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195, 04-36, 03-109, 02-60, CC Docket Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286, at 7 (filed Sept. 30, 2008) (NASUCA Sept. 30, 2008 *Ex Parte* Letter) (arguing that the growth in the contribution factor is "almost entirely" due to the growth in universal service disbursement requirements).

[213] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 1.2a (2001) (2001 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/mrs01-0.pdf; 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.11; *see also* USAC 2007 ANNUAL REPORT at 3, 51 (detailing universal service disbursements for 2007 at approximately $6.9 billion).

[214] The contribution factor grew from 5.9% in the first quarter of 2000 to 11.3% for the fourth quarter of 2008. *See Proposed First Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 15 FCC Rcd 3660 (WCB 1999); *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD Sept. 12, 2008) (*Fourth Quarter 2008 Contribution Factor Public Notice*).

[215] *See* 47 U.S.C. §§ 254(b), (d).

non-telecommunications products and services.[216] The integration of local and long-distance wireline services into packages that allow customers to purchase buckets of long distance minutes and local service for a single price blurs the distinction between revenue derived from intrastate telecommunications service and interstate telecommunications service. Similarly, the availability of mobile wireless calling plans that allow customers to purchase buckets of minutes on a nationwide network without incurring roaming or long-distance charges also makes it difficult for providers and the Commission to identify the amount of revenue derived from interstate telecommunications service.[217] Further, migration to interconnected VoIP services complicates the distinctions

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[216] Although the Commission has established safe harbors for the reporting of interstate telecommunications revenues derived from interstate telecommunications services bundled with customer premises equipment (CPE) or information services, it has not established guidelines for reporting interstate telecommunications service revenues for flat-rated bundles of wireline interstate and intrastate services. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review—Review of Customer Premises Equipment and Enhanced Local Exchange Markets*, CC Docket Nos. 96-61, 98-183, Report and Order, 16 FCC Rcd 7418, 7446-48, paras. 47-54 (2001) (*CPE Bundling Order*).

[217] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 21252, 21258-59, paras. 13-15 (1998) (*First Wireless Safe Harbor Order*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, 24965-67, paras. 21-25 (2002) (*Second Wireless Safe Harbor Order*).

that serve as the basis for current contribution obligations.[218]

92. In 2001 and 2002, the Commission sought comment on modifications to the existing revenue-based contribution methodology, and on replacing that methodology with one that assesses contributions on the basis of a flat-fee charge, such as a per-line charge.[219] The Commission also sought comment on other universal service contribution methodologies, including moving to a numbers-based methodology.[220] Finally, in May 2008, the Commission encouraged commenters to refresh the re-

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[218] *See Universal Service Contribution Methodology*, WC Docket Nos. 06-122, 04-36, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518 (2006) (*2006 Interim Contribution Methodology Order*); *aff'd in part, vacated in part sub nom. Vonage Holdings Corp. v. FCC*, 489 F.3d 1232 (D.C. Cir. 2007).

[219] *See Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001) (*2001 Contribution NPRM*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Further Notice of Proposed Rulemaking and Report and Order, 17 FCC Rcd 3752, 3765, para. 31, 3766-89, paras. 34-83 (2002) (*Contribution First FNPRM*).

[220] *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24983-97, paras. 66-100 (seeking comment on capacity-based proposals that had been developed in the record and on telephone-number proposals advocated by certain parties); *Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Public Notice, 18 FCC Rcd 3006 (2003) (*Contribution Staff Study*) (seeking comment on a Commission staff study that estimated potential contribution assessment levels under the then-newly modified revenue-based method and the three connection-based proposals in the further notice portion of the *Second Wireless Safe Harbor Order*).

cord in several pending intercarrier compensation and universal service reform proceedings, including the contribution methodology proceeding.[221]

B. Discussion

93. The system of contributions to the universal service fund is broken. The Commission has repeatedly patched the current system to accommodate decreasing interstate revenues, a trend toward "all-you-can-eat" services that make distinguishing interstate from other revenues difficult if not impossible and changes in technology. While the service developments that precipitated these changes have enormous consumer benefits, they have also severely strained the contributions system.[222] We therefore adopt today a system of contributions that will assess a $1.00 contribution per residential telephone

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[221] *Interim Cap Clears Path for Comprehensive Reform: Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

[222] We agree with commenters who argue that the contribution methodology requires a comprehensive overhaul. *See, e.g.*, Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. 1 at 1 (filed Sept. 11, 2008) (AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter); Letter from Roger C. Sherman, Director, Government Affairs—Wireless Regulatory, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 04-36 at 1 (filed June 14, 2006) (Sprint Nextel June 14, 2006 *Ex Parte* Letter); Letter from Susanne A. Guyer, Senior Vice President Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 06-122 at 2 (filed Oct. 28, 2008) (Verizon Oct. 29, 2008 *Ex Parte* Letter); Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 1 (filed Oct. 20, 2008) (AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter).

number per month, and we will move to a connections-based system for business services. In this part, we explain our legal authority to move to these new methodologies, why we have decided to move to these methodologies, and how the residential numbers-based system will work.

1. Legal Authority

94. The Commission has ample authority to require contributions from the variety of providers discussed below. The Commission's authority derives from several sections of the Act: section 254(d), Title I, and section 251(e). These sections of the statute provide us authority to require contributions from the kinds of service providers we address below in our discussions of the new numbers-based approach for residential services and the connections-based approach for business services.

95. Section 254 is the cornerstone of the Commission's universal service program. Section 254(d) first provides that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[223] Under this "mandatory contribution" provision, every provider of telecommunications services[224] must contribute, although the Commission has authority to exempt a carrier or class of carriers if their contributions would be *de minimis*.[225]

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[223] 47 U.S.C. § 254(d).

[224] Section 254(d) refers to "telecommunications carriers," which are defined as "any provider of telecommunications services." 47 U.S.C. § 153(44).

[225] 47 U.S.C. § 254(d).

96. Section 254(d) also provides that the Commission may require "[a]ny other provider of interstate telecommunications . . . to contribute to the preservation and advancement of universal service if the public interest so requires."[226] The Commission has relied on this "permissive authority" to require various providers of telecommunications,[227] but not necessarily telecommunications *services*,[228] to contribute. For example, the Commission has required entities that provide interstate telecommunications to others on a private contractual basis to contribute to the universal service fund,[229] as well as payphone aggregators.[230] Most recently, we required interconnected VoIP providers to contribute even though the

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[226] 47 U.S.C. § 254(d).

[227] "Telecommunications" is defined as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43).

[228] "Telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46).

[229] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9183-84, paras. 794-95. We note that private service providers that provide interstate connections solely to meet their internal needs (i.e., self-providers) will not be required to contribute under the new methodology. This is consistent with our current policy. In the *Universal Service First Report and Order*, the Commission reasoned that, for self-providers of interstate telecommunications, the telecommunications is incidental to their primary non-telecommunications business. *See Universal Service First Report and Order*, 12 FCC Rcd at 9185, para. 799.

[230] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9184-85, paras. 796-98. *But see* Letter from Robert F. Aldrich, Counsel for the American Public Communications Council (APCC), to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 01-92, Attach. (filed Oct. 23, 2008).

Commission has not determined that they are telecommunications carriers. Specifically, in the *2006 Interim Contribution Methodology Order*, we used our permissive authority under section 254(d) to require interconnected VoIP providers to contribute, and we noted that they "provide" telecommunications to their end users.[231] We also noted that in some cases, the interconnected VoIP provider may be "providing" telecommunications even if it arranges for the end user to have PSTN access through a third party.[232]

97. The Commission also has authority under Title I to require other service providers to contribute. In general, the Commission can rely on its ancillary jurisdiction under Title I when the Commission has subject matter jurisdiction over the service to be regulated, and the assertion of jurisdiction is "reasonably ancillary to the effective performance of [its] various responsibilities."[233] The Commission relied on this authority before section 254 was added by the 1996 Act to establish a high-cost support fund,[234] which the U.S. Court of Appeals for the D.C. Circuit found to be a permissive exercise of Title I

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[231] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7538-40, paras. 39-41; 47 C.F.R. § 54.706(a).

[232] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41 ("To provide this capability [telecommunications], interconnected VoIP providers may rely on their own facilities or provide access to the PSTN through others.").

[233] *See United States v. Southwestern Cable Co.*, 392 U.S. 157, 177-78 (1968); *United States v. Midwest Video Corp.*, 406 U.S. 649, 667-68 (1972); *FCC v. Midwest Video Corp.*, 440 U.S. 689, 700 (1979); *see also American Library Ass'n v. FCC*, 406 F.3d 689 (D.C. Cir. 2005).

[234] *See Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Decision and Order, 96 F.C.C.2d 781, (1984), *aff'd sub nom. Rural Tel. Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988).

authority.[235] And more recently in the *2006 Interim Contribution Methodology Order*, the Commission relied on its ancillary jurisdiction under Title I as an additional source of authority to require contributions from interconnected VoIP providers.[236] In that order, the Commission noted that the Act grants subject matter jurisdiction over interconnected VoIP because it involves "transmission" of voice by wire or radio,[237] and that imposing contribution obligations on interconnected VoIP providers was "reasonably ancillary" to the effective performance of the Commission's responsibilities to establish "specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service."[238] In particular, the Commission noted that interconnected VoIP providers "benefit from their interconnection to the PSTN."[239]

98. In addition, Congress provided the Commission with "plenary authority" over numbering in section 251(e). Specifically, the Commission has "exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States."[240] The Commission relied on its authority under section 251(e)

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[235] *Rural Tel. Coalition*, 838 F.2d at 1315.

[236] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7541-43, paras. 46-49.

[237] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 47 & n.160 (citing *IP-Enabled* Services, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245 (2005) (*VoIP 911 Order*), *aff'd sub nom. Nuvio Corp. v. FCC*, 473 F.3d 302 (D.C. Cir. 2006); 47 U.S.C. § 152(a)).

[238] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48 (quoting 47 U.S.C. § 254(d)).

[239] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48.

[240] 47 U.S.C. § 251(e)(1).

to support its action to require interconnected VoIP providers to provide E911 services.[241] The Commission noted that it exercised its authority under section 251(e) because, among other reasons, "interconnected VoIP providers use NANP numbers to provide their services."[242]

99. These sections of the Act provide the Commission ample authority to require contributions from all providers subject to the new numbers-based and connections-based approaches described in more detail below. These methodologies may require some providers to contribute directly to universal service when in the past they may have been contributing only indirectly or not at all. For example, under the numbers-based approach, any provider who assigns an "Assessable Number" to a residential user must contribute $1.00 per number per month.[243] Providers such as VoIP providers who are not "interconnected VoIP" providers, electronic facsimile service providers, Internet-based TRS providers, one-way and two-way paging service providers, and telematics providers may assign Assessable Numbers to residential users and maintain the retail relationship with the end users.[244] Not all of these providers are "telecommunications carriers" subject to the mandatory contribution obligation of section 254(d). Nonetheless, we have authority to require them to contribute. First, all of these providers provide—directly or indirectly—some amount of intercon-

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[241] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

[242] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

[243] The term Assessable Number is defined below. *See infra* paras. 115-129.

[244] This list is meant to be illustrative, not exhaustive. Other providers may also have to contribute to the universal service fund based on the criteria described in this order.

nection to the public switched telephone network (PSTN), the network that universal service supports. Interconnection to the PSTN benefits the consumers of each of these types of services, facilitating communication (even if just one-way communication) between the end user and PSTN users. As we noted in the *2006 Interim Contribution Methodology Order*, interconnected VoIP providers often provide access to the PSTN via third parties[245] and this is sufficient to permit the Commission to rely on its authority to require contributions from "other provider[s] of interstate telecommunications."[246] And as we explain below, it is in the public interest (as required by section 254(d)) that these providers contribute. Furthermore, the prerequisites for the use of our Title I ancillary jurisdiction are unquestionably met here. All the services that rely on assignment of an Assessable Number to a residential end user come within the Commission's broad subject matter jurisdiction because they involve in some manner "interstate . . . communication by wire or radio."[247] And similar to our explanation in the *2006 Interim Contribution Methodology Order*, requiring contributions from providers who take advantage of PSTN connectivity whether directly or indirectly makes sense because their end users benefit from the ubiquity of that network and from being somehow interconnected with it.[248] Finally, our plenary au-

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[245] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41.

[246] 47 U.S.C. § 254(d).

[247] 47 U.S.C. § 152(a); *see also VoIP 911 Order*, 20 FCC Rcd 10261-62, para. 28 (providing detailed explanation of why interconnected VoIP falls within the Commission's subject matter jurisdiction).

[248] *Compare 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7540, para. 43.

thority over numbering supports our actions here with regard to a numbers-based methodology for residential services. The purpose of a uniform system of numbering is to facilitate communication on interconnected networks based on a standardized system of identifiers—telephone numbers.[249] Those customers who are assigned telephone numbers, whether for plain old telephone service (POTS) or for any other service, are using the numbers to take advantage of some feature of the PSTN, whether it is the capability to be called, to have their locations automatically relayed to emergency call handlers, to be faxed from anywhere, or for some other reason. Because customers are receiving this benefit, it is appropriate that their service providers (and ultimately, likely, the customers themselves) contribute to the ubiquity and support of the network from which they are benefiting.

100. We reject suggestions that we do not have authority to require contributions based on numbers or connections because we lack authority over intrastate

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[249] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Second Report and Order and Memorandum Opinion and Order, 11 FCC Rcd 19392, 19404, 19407, paras. 19, 25 (1996) (noting that numbering administration ensures the creation of a nationwide, uniform system of numbering essential to the efficient delivery of interstate and international telecommunications services and the development of a competitive telecommunications services market) (subsequent history omitted); *see also Administration of the North American Numbering Plan*, CC Docket No. 95-283, Report and Order, 11 FCC Rcd 2588, 2591, para. 4 (1995) ("Adequate telephone numbers, available through a uniform numbering plan, are essential to provide consumers efficient access to new telecommunications services and technologies and to support continued growth of an economy increasingly dependent upon those services and technologies."); *Administration of the North American Numbering Plan*, CC Docket No. 92-237, Notice of Proposed Rulemaking, 11 FCC Rcd 2068, para. 2 (1994).

services.[250] The same number or connection typically is used for both interstate and intrastate services. The Commission and courts have rejected the assertion that simply because a single facility has the capacity to provide both interstate and intrastate services, the Commission lacks authority to regulate any aspect of the facility.[251] In fact, the subscriber line charge (SLC) that the Commission established is intended to capture the *interstate* cost of the *local* loop.[252] The contribution methodologies we adopt are thus limited to assessments on services that can provide interstate service. We will only require providers to contribute to universal service based on the Assessable Numbers or connections that are capable of originating or terminating interstate or international communications.[253]

2. The New Numbers-Based Assessment Methodology for Residential Services

101. As discussed above, we adopt a new contribution methodology for residential services based on assessing telephone numbers, rather than interstate and interna-

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[250] *See, e.g.*, American Association of Paging Carriers (AAPC) *Contribution First FNPRM* Comments at 7; Alaska Communication Systems (ACS) *Contribution First FNPRM* Reply at 6-7; Allied Personal Communications Industry Association of California (Allied) *Contribution First FNPRM* Comments at 6-7; National ALEC Association/Prepaid Communications Association (NALA/PCA) *Contribution First FNPRM* Reply at 3.

[251] *See, e.g.*, *NARUC v. FCC*, 737 F.2d 1095, 1113 (D.C. Cir. 1984) ("The same loop that connects a telephone subscriber to the local exchange necessarily connects that subscriber into the interstate network as well.").

[252] *NARUC v. FCC*, 737 F.2d at 1113-14.

[253] Services that provide only intrastate communications and do not traverse a public interstate network will not be required to contribute under the new assessment methodology.

tional services revenue. We find that this change will benefit contributors and end users by simplifying the contribution process and providing predictability as to the amount of universal service contributions and pass-through charges for residential services. For residential services, we set the contribution amount at a flat $1.00 per month charge for each number associated with residential services.

a. Benefits of a Numbers-Based Contribution Methodology

102. We find that adoption of a telephone number-based methodology for residential services will help preserve and advance universal service by ensuring a specific, predictable, and sufficient funding source, consistent with the universal service principles of section 254(b) of the Act.[254] Changes in technology and services have made the revenue-based contribution mechanism difficult to administer. As commenters have noted, the distinction between intrastate and interstate revenues is blurring as providers move from their traditional roles as pure LECs or interexchange carriers (IXCs) to businesses that offer consumers the choice of purchasing their telecommunications needs from a single source.[255] Additionally, these providers are offering consumers greater flexibility, such as bundling of local and long distance service at a flat rate.[256] Moreover, technologies such as wireless and in-

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[254] 47 U.S.C. § 254(b)(5).

[255] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1.

[256] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Nov. 19, 2007) (Ad Hoc Nov. 19, 2007 *Ex Parte* Letter) (discussing the convergence of

terconnected VoIP have emerged that provide voice and data services that know no jurisdictional boundaries.[257] Consumers benefit from the opportunity to obtain bundled services, and the universal service contribution mechanism should reflect and complement those marketplace and technological developments as much as possible. Our decision to use numbers as the basis for assessing contributions for residential services will enhance the specificity and predictability of entities' contributions.

103. Our adoption of a numbers-based contribution methodology will benefit both residential consumers and contributors by simplifying the basis for assessments and stabilizing assessments at a set amount of $1.00 per month per residential telephone number.[258] Contributors are allowed, and in most cases do, recover their universal service contribution costs from fees assessed on their end-user customers.[259] Under the revenue-based contribution mechanism, a provider's contribution costs fluctuated from quarter to quarter, causing consumers' universal service fees to fluctuate as well. These fluctuations did not allow customers to anticipate changes to their fees. A set $1.00-per-number contribution assessment is simple and predictable for both contributors and for consumers. To the extent a contributor elects to recover its

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different applications for business and residential customers onto a single integrated network with bundled pricing).

[257] *See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, 22412-14, paras. 16-18 (2004) (*Vonage Order*), *aff'd sub nom. Minnesota Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir. 2007).

[258] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2.

[259] Contributors are prohibited from passing through to subscribers more than their contribution cost. 47 C.F.R. § 54.712.

contribution costs through end-user fees, its residential customers will pay the same $1.00 fee per number each month, making the assessment simple and predictable.[260]

104. A numbers-based contribution methodology also benefits residential end users because it is technologically and competitively neutral. A consumer will pay the same universal service charge regardless of whether the consumer receives residential service from a cable provider, an interconnected VoIP provider, a wireless provider, or a wireline provider. This will enable residential consumers to choose the providers and provider types they want without regard to any artificial distortions that would otherwise be caused by differing contribution charges.[261] In a marketplace characterized by increased competition within and between different technology platforms, residential consumers will receive the same universal service charge regardless of the type of service the customer chooses.

105. Similarly, by subjecting contributors to the same regulatory framework for assessments on residential ser-

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[260] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also* Information Technology Industry Council (ITI) *2006 Contribution FNPRM* Comments at 6; NCTA *2006 Contribution FNPRM* Comments at 5; Small Business Administration Office of Advocacy (SBA) *2006 Contribution FNPRM* Comments at 8; Vonage *2006 Contribution FNPRM* Comments at 7-8; Letter from Gregory V. Haledjian, Regulatory and Governmental Relations, Counsel to IDT Corporation and USF By the Numbers Coalition, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, Attach. at 3-4 (filed Jan. 30, 2007).

[261] *See, e.g.*, NCTA *2006 Contribution FNPRM* Comments at 5; Vonage *2006 Contribution FNPRM* Comments at 6; Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, 01-92, CC Docket Nos. 96-45, 99-68, 96-262 at 2 (filed July 15, 2008).

vices regardless of technology, the numbers-based methodology will eliminate incentives under the current revenue-based system for providers to migrate to services and technologies that are either exempt from contribution obligations or are subject to safe harbors.[262] The elimination of such incentives will result in a more competitively and technologically neutral marketplace and a more predictable source of funding for the universal service mechanisms.

106. The adoption of a fixed $1.00 per residential number per month contribution assessment is specific and predictable and will simplify the administration of universal service contributions.[263] Interstate end-user telecommunications revenues have become increasingly difficult to identify, particularly for residential services, due to increased bundling of local and long distance ser-

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[262] *See* AT&T *2006 Contribution FNPRM* Comments at 4.

[263] In addition to being easily administrable, the record supports adoption of $1.00 per month as the residential per-number assessment amount. *See, e.g.*, Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, Attach. at 3 (filed Oct. 25, 2005); *see* Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 3 (filed Sept. 23, 2008) (AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter) (estimating a $1.01 per-number per-month assessment under a numbers-based contribution methodology); *see also* Letter from Paul Garnett, Assistant Vice President, CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45 at 1 (filed Oct. 2, 2008) (CTIA Oct. 2, 2008 *Ex Parte* Letter), Attach. at 5 (supporting the AT&T and Verizon proposal); Letter from David B. Cohen, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. at 1 (filed Sept. 25, 2008).

vice and the growth of consumer interconnected VoIP offerings.[264] In contrast, telephone numbers provide an easily identifiable basis for contribution.[265] The amount of North American Numbering Plan (NANP) telephone numbers in use has shown steady, stable growth, providing a fairly constant basis for estimating universal service support amounts.[266] The new methodology, based on a flat $1.00 per residential number per month, will be easier to administer, facilitating greater regulatory compliance. A numbers-based contribution methodology will also be readily applicable to emerging service offerings. The new methodology minimizes the potential for providers to avoid contributions by bundling intrastate revenues with interstate revenues or engaging in other bypass activities.[267]

107. Further, assessing universal service contributions based on residential telephone numbers will

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[264] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.1.

[265] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* ALEXANDER BELINFANTE, FCC, TELEPHONE SUBSCRIBERSHIP IN THE UNITED STATES, tbl. 1 (2008), *available at* http://hraunfoss.fcc.gov/edocs_lic/attachmatch/DOC284923A1.pdf.

[266] *See* CRAIG STROUP AND JOHN VU, FCC, NUMBERING RESOURCE UTILIZATION IN THE UNITED STATES, tbl. 12 (2008) (showing number utilization from December 2000 to December 2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284926A1.pdf.

[267] *See* Ad Hoc *Contribution First FNPRM* Comments at 6-7; Coalition for Sustainable Universal Service (CoSUS) *Contribution First FNPRM* Comments at 38; Sprint *Contribution First FNPRM* Comments at 8-9. Because residential services will no longer be assessed based on revenues, contributors may not mark-up or otherwise adjust the $1.00 per Assessable Number per month residential contribution assessment in response to uncollectible revenues.

promote number conservation.[268] Telephone numbers are a finite, public resource. If contributors are assessed based on the residential telephone numbers assigned to them, they will have an incentive to efficiently manage their numbering resources in a manner that minimizes their costs. We expect that this will result in the need for fewer area code splits or overlays due to number exhaust.[269]

108. Our adoption of a numbers-based contribution methodology for residential services is consistent with the goal of ensuring just, reasonable, and affordable rates.[270] The per-number assessment of $1.00 per number per month will represent a reduction in pass-through charges for many residential customers.[271] Although the

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[268] *See, e.g.*, ITI *2006 Contribution FNPRM* Comments at 6; Vonage *2006 Contribution FNPRM* Comments at 7.

[269] *See Numbering Resource Optimization*, CC Docket No. 99-200, Report and Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 7574, 7625, para. 122 (2000) (*NRO I Order*) (determining that implementation of thousands-block number pooling is essential to extending the life of the NANP by making the assignment and use of NXX codes more efficient); *see also Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Fourth Report and Order, 18 FCC Rcd 12472, 12474, para. 5 (2003) (*NRO IV Order*) (explaining further that thousands-block number pooling is a numbering resource optimization measure in which 10,000 numbers in an NXX are divided into ten sequential blocks of 1,000 numbers and allocated to different service providers (or different switches) within a rate center).

[270] 47 U.S.C. § 254(b)(1).

[271] *See* Letter from Jean L. Kiddoo and Tamar E. Finn, Counsel to IDT Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Aug. 2, 2007) (IDT Aug. 2, 2007 *Ex Parte* Letter) (showing that the average residential household paid about $1.37 in universal service fees in 2006). IDT claims the data show that the lowest-income consumers paid an average of $1.09 in universal service fees for wireline telephone bills. *Id.* at 6.

$1.00 per number per month assessment may represent an increase in universal service charges for residential customers that make few or no long distance calls, this increase should be slight. Under the current revenue-based contribution mechanism, providers may assess a federal universal service fee on the basis of the customer's SLC. The residential SLC may be as high as $6.50 per month.[272] Based on the most recent contribution factor of 11.4 percent, even a customer who made no long distance calls could thus be assessed $0.74 per month in universal service charges under the existing revenue-based methodology.[273] Thus, the potential increase for a customer who makes no long distance calls could be as little as $0.26 per month under the $1.00 per number methodology. In addition, we have separate protections to ensure that telephone service remains affordable for low-income subscribers.[274]

109. Some commenters assert that assessing a flat universal service charge is inherently unfair because it does not take into account the fact that some people make many interstate and international calls, while others make few if any such calls in a given month.[275] We

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[272] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1). The SLC is referred to as the End User Common Line Charge in the Commission's rules.

[273] The revenue from the $6.50 SLC would be multiplied by the 11.4% contribution factor, resulting in a contribution amount and corresponding assessment of $0.74. *See Fourth Quarter 2008 Contribution Factor Public Notice* at 1; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 3.

[274] *See* 47 C.F.R. § 54.400 *et seq.*; *infra* para. 141 (describing contribution exemptions for services to low-income consumers).

[275] *See, e.g.*, Letter from Maureen A. Thompson, Executive Director, Keep USF Fair Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 5-7 (filed Mar. 27, 2006) (Keep USF

disagree. We find that imposition of a flat charge is warranted because all contributors and their subscribers receive a benefit from being connected to the public network, enabling them to make and receive interstate calls.[276] The *ability* to make or receive interstate calls over a public network is a significant benefit and it is reasonable to assess universal service contributions for residential customers based on access to the network. Customers who do not make any interstate calls still receive the benefit of accessing the network to *receive* interstate calls. The $1.00 per month per number assessment reflects our finding that it is equitable for providers to contribute a fixed amount based on the ability to access and utilize a ubiquitous public network.

110. Some commenters allege that changing from the current revenue-based methodology to a new mechanism based on telephone numbers would not be equitable because it could reduce contributions from certain industry segments and increase them for others.[277] Although the change to a numbers-based contribution methodology for residential services will result in changes in the relative contribution obligations of industry segments, the new contribution methodology is not inequitable or discriminatory. The evolving nature of the telecommunications marketplace and of its participants requires the Commis-

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Fair Mar. 27, 2006 *Ex Parte* Letter); *see also* NASUCA Sept. 30, 2008 *Ex Parte* Letter at 9.

[276] *Universal Service First Report and Order*, 12 FCC Rcd at 8783, para. 8

[277] *See, e.g.*, FW&A *Contribution First FNPRM* Comments at 13-15; NRTA and OPASTCO *Contribution First FNPRM* Comments at 7-11; SBC *Contribution First FNPRM* Comments at 18; Verizon *Contribution First FNPRM* Reply at 6; Verizon Wireless *Contribution First FNPRM* Comments at 5-6.

sion to periodically review and revise the contribution methodology to ensure that providers continue to be assessed on an equitable and non-discriminatory basis. We find that, given the difficulties in continuing to assess contributions entirely on a revenue-based methodology and the benefit to residential consumers of access to the public network, it is equitable to adopt a numbers based contribution methodology that assesses a $1.00 per month per number fee for residential services.

b. Assessable Numbers

111. Below, we describe the telephone numbers for which service providers are obligated to contribute to the universal service fund. We call these "Assessable Numbers." The Commission has addressed certain reporting based on telephone numbers in other contexts. In the number utilization context, the Commission requires that each telecommunications carrier that receives numbering resources from the North American Numbering Plan Administrator (NANPA), the Pooling Administrator, or another telecommunications carrier report its numbering resources in each of six defined categories of numbers set forth in section 52.15(f) of our rules.[278] In the regulatory

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[278] These six categories of numbers are defined as follows:

(i) Administrative numbers are numbers used by telecommunications carriers to perform internal administrative or operational functions necessary to maintain reasonable quality of service standards.

(ii) Aging numbers are disconnected numbers that are not available for assignment to another end user or customer for a specified period of time. Numbers previously assigned to residential customers may be aged for no more than 90 days. Numbers previously assigned to business customers may be aged for no more than 365 days.

(iii) Assigned numbers are numbers working in the Public Switched Telephone Network under an agreement such as a

fee context, the Commission used the category of "assigned numbers" as the starting point for determining how to assess fees on certain providers, but found it necessary to modify that definition to account for the different regulatory contexts. Specifically, in assessing regulatory fees for commercial mobile radio service (CMRS) providers that report number utilization to NANPA based on the reported assigned number count in their Numbering Resource Utilization and Forecast (NRUF) data, the Commission requires these providers to adjust their assigned number count to account for number porting. The Commission found that adjusting the NRUF data to account for porting was necessary for the data to

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contract or tariff at the request of specific end users or customers for their use, or numbers not yet working but having a customer service order pending. Numbers that are not yet working and have a service order pending for more than five days shall not be classified as assigned numbers.

(iv) Available numbers are numbers that are available for assignment to subscriber access lines, or their equivalents, within a switching entity or point of interconnection and are not classified as assigned, intermediate, administrative, aging, or reserved.

(v) Intermediate numbers are numbers that are made available for use by another telecommunications carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer. Numbers ported for the purpose of transferring an established customer's service to another service provider shall not be classified as intermediate numbers.

(vi) Reserved numbers are numbers that are held by service providers at the request of specific end users or customers for their future use. Numbers held for specific end users or customers for more than 180 days shall not be classified as reserved numbers.

47 C.F.R. § 52.15(f)

be sufficiently accurate and reliable for purposes of regulatory fee assessment.[279]

112. We adopt a new term based on the category of assigned numbers to represent the numbers being assessed for universal service contribution purposes—"Assessable Numbers." The definition of Assessable Numbers that we adopt focuses on those numbers that are actually in use by end users for services that traverse a public interstate network. Specifically, we define an Assessable Number as a NANP telephone number or functional equivalent identifier[280] in a public or private network that is in use by a residential end user and that enables the residential end user to receive communications from or terminate communications to (1) an interstate public telecommunications network or (2) a network that traverses (in any manner) an interstate public telecommunications network.[281] Assessable Numbers include geographic as well as non-geographic telephone numbers (such as toll-free numbers and 500-NXX numbers) so

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[279] *See Assessment and Collection of Regulatory Fees for Fiscal Year 2005, Assessment and Collection of Regulatory Fees for Fiscal Year 2004*, MD Dockets No. 05-59, 04-73, Report and Order and Order on Reconsideration, 20 FCC Rcd 12259, 12271, paras. 39-40 (2005).

[280] "Functional equivalent identifier" means an identifier used in place of and with the same PSTN access capability as a NANP number; it is not intended to capture identifiers used in conjunction with NANP numbers, such as internal extensions that cannot be directly dialed from the PSTN. Nor is "functional equivalent identifier" intended to capture routing identifiers used for routing of Internet traffic, unless such identifiers are used in place of a NANP number to provide the ability to make or receive calls on the PSTN.

[281] For purposes of the definition of Assessable Numbers, we include only the NANP telephone numbers used in the United States and its Territories and possessions.

long as they meet the other criteria described in this part for Assessable Numbers.

113. The provider with the retail relationship to the residential end user is the entity responsible for contributing.[282] We impose the contribution obligation on the provider with the retail relationship to the end user for several reasons. First, this provider will have the most accurate and up-to-date information about how many Assessable Numbers it currently has assigned to end users. Second, this provider is also in the best position to distinguish residential users from business users, and thus to determine how many of its telephone numbers in use are Assessable Numbers. Finally, this provider, and its users, are benefiting from a supported PSTN, and thus it is sound policy to require them to contribute to its support.[283] We note that today, providers are permitted to pass through their contribution assessments to end us-

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[282] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844; *see also, e.g.*, Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 7 (filed Sept. 24, 2008) (Qwest Sept. 24, 2008 *Ex Parte* Letter); AT&T and Verizon Sept. 11, 2008, *Ex Parte* Letter, Attach. 1 at 1-2; Letter from Brad E. Mutschelknaus, Counsel for XO Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 04-36, Attach. at 9 (filed Oct. 3, 2008); Letter from Donna N. Lampert, Counsel for Google, to Marlene H. Dortch, Secretary, FCC (filed Oct. 3, 2008) (Google Oct. 3, 2008 *Ex Parte* Letter); *see also* 47 C.F.R. § 54.5 (defining "contributor" as "an entity required to contribute to the universal service support mechanism pursuant to § 54.706 [of the Commission's rules]").

[283] *See supra* para. 103 (discussing the public interest in requiring these entities to support the network).

ers, and we understand that they typically do so.[284] Under the new methodologies, they may continue to do so, subject to the same requirement that they will not pass through more than their contribution amount.[285]

114. Next, we specify whether certain types of numbers are included in the definition of Assessable Numbers. First, numbers used for intermittent or cyclical purposes are included in the definition of Assessable Numbers. Numbers used for cyclical purposes are numbers designated for use that are typically "working" or in use by the end user for regular intervals of time. These numbers include, for example, an end user's summer home telephone number that is in service for six months out of the year.[286] In the *NRO III Order*, the Commission clarified that these types of numbers should generally be categorized as "assigned" numbers if they meet certain thresholds and that, if they do not meet these thresholds, they "must be made available for use by other customers" (i.e., they are "available" numbers).[287] Because these

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[284] *See, e.g.*, AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24978, para. 50.

[285] 47 C.F.R. § 54.712.

[286] *See Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Third Report and Order and Second Order on Reconsideration in CC Docket No. 96-98 and CC Docket No. 99-200, 17 FCC Rcd 252, 303, para. 119 (2001) (*NRO III Order*).

[287] *NRO III Order*, 17 FCC Rcd at 304, para. 122 ("With this requirement, we seek to limit the amount of numbers that are set aside for use by a particular customer, but are not being used to provide service on a regular basis. Thus, in order to categorize such blocks of numbers as assigned numbers, carriers may have to decrease the amount [of] numbers set aside for a particular customer. We also clarify that numbers 'working' periodically for regular intervals of time, such as numbers assigned to summer homes or student residences, may be categorized as assigned numbers, to the extent that

numbers are assigned to end users, we find they should be included in the definition of Assessable Numbers we adopt today.

115. We exclude from our definition of Assessable Numbers those telephone numbers that satisfy the section 52.15 definition of "assigned numbers" solely because the "numbers [are] not yet working but hav[e] a customer service order pending" for five days or less.[288] Providers generally do not bill for services that have yet to be provisioned and therefore are not compensated for services during the pendency of the service order. Moreover, such numbers are not yet operational to send or receive calls. Thus, under the existing contribution methodology, providers would not contribute for services they are about to provide (but have not yet provided) under a pending service order. We continue to find it appropriate for contributors not to be required to contribute to the universal service fund for pending service orders.

116. We exclude from the definition of Assessable Numbers those telephone numbers that telecommunications providers have transferred or ported to a carrier using resale or the unbundled network element platform. Under prior numbering orders, such telephone numbers would still be included in the NRUF assigned number count of the transferring-out carrier.[289] Consistent with

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they are 'working' for a minimum of 90 days during each calendar year in which they are assigned to a particular customer. Any numbers used for intermittent or cyclical purposes that do not meet these requirements may not be categorized as assigned numbers, and must be made available for use by other customers.").

[288] *See* 47 C.F.R. § 52.15(f)(iii).

[289] *NRO I Order*, 15 FCC Rcd at 7586-87, para. 18. Ported-out numbers, a subcategory of assigned numbers, are not reported to NANPA although NRUF reporting carriers are required to main-

our definition of Assessable Numbers, because the underlying provider no longer maintains the retail relationship with the end user, the provider should not include these numbers in its Assessable Number count. Conversely, the receiving provider of such transferred customers would include the associated telephone numbers in their count of Assessable Numbers.

117. We exclude from the definition of Assessable Numbers those numbers that meet the definition of an Available Number, an Administrative Number, an Aging Number, or an Intermediate Number as those terms are defined in section 52.15(f) of the Commission's rules.[290] For a particular carrier, the carrier will not have an end user associated with a number in any of these categories of numbers. For example, an intermediate number is a number that is "made available for use by another telecommunications carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer."[291] The receiving provider will be responsible for including the number as an Assessable Number once it provides the number to an end user.[292]

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tain internal records associated with these numbers for five years. *Id.* at 7592, 7601, paras. 36, 62.

[290] *See* 47 C.F.R. § 52.15(f); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 7 (arguing, among other things, that numbers used for administrative purposes and numbers that are not "actively" working, such as aging, unassigned, reserved numbers, and numbers donated back to the industry pool should be excluded from the contributor's base).

[291] *See* 47 C.F.R. § 52.15(f)(v).

[292] *See NRO I Order*, 15 FCC Rcd at 7587, para. 21 (2000) ("We agree with commenters who opine that [intermediate] numbers should not be categorized as *assigned* numbers because they have not been assigned to an end user. . . . We therefore conclude that numbers that are made available for use by another carrier or non-

118. We exclude non-working telephone numbers from the definition of Assessable Number. Carriers report as assigned numbers for NRUF purposes entire codes or blocks of numbers dedicated to specific end-user customers if at least fifty percent of the numbers in the code or block are working in the PSTN.[293] Consistent with our definition of Assessable Numbers, carriers should not include the non-working numbers in these blocks in their Assessable Number counts, because the non-working numbers portion of these blocks are not providing service to the end user.

119. We exclude from the definition of Assessable Number those numbers that are used merely for routing purposes in a network, so long as such numbers are always—without exception—provided without charge to the end user, are used for routing only to Assessable Numbers for which a universal service contribution has been paid, and the ratio of such routing numbers to Assessable Numbers is no greater than 1:1. For example, a NANP number used solely to route or forward calls to a residential number, office number, and/or mobile number would be excluded from our definition of Assessable Number if such routing number were provided for free, and such number routes calls only to Assessable Numbers. If, however, such routing or forwarding is provided for a fee, such as with remote call forward service or foreign exchange service, both the routing number and the end user number to which calls are routed or forwarded would be considered Assessable Numbers.

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carrier entity for the purpose of providing telecommunications service to an end user or customer should be categorized as *intermediate* [numbers].").

[293] *NRO III Order*, 17 FCC Rcd at 304, para. 122.

120. In addition, incumbent LECs need not include numbers assigned to wireless providers that interconnect at the end office of an incumbent LEC and have obtained numbers directly from the incumbent LEC.[294] Because the incumbent LEC does not have the retail relationship with the end user, it should not include these numbers in its Assessable Number count. The wireless carriers that have the retail relationship with the end users must include these telephone numbers in their Assessable Number count.

121. Finally, we exclude from the definition of Assessable Numbers those numbers associated with Lifeline services for the reasons described below.[295]

122. We do not restrict our definition to numbers that exclusively use the PSTN.[296] As noted above, evolution in communications technology away from the PSTN to alternative networks that may only partially (if at all) trav-

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[294] When a wireless carrier interconnects at an incumbent LEC end office it is known as a Type 1 interconnection. *See Federal Communications Commission Seeks Comment on Initial Regulatory Flexibility Analysis in Telephone Number Portability Proceeding*, CC Docket No. 95-116, Public Notice, 20 FCC Rcd 8616, 8632, App. B at para. 19 n.53 (2005) ("Type 1 numbers reside in an end office of a LEC and are assigned to a Type 1 interconnection group, which connects the wireless carrier's switch and the LEC's end office switch.").

[295] *See infra* paras. 140-46.

[296] The record is split over whether the definition of an assessable number should be restricted to the PSTN. AT&T and Verizon, for example, do not include such a requirement in their proposed definitions. *See* AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 1. Other commenters, however, argue for such a requirement. *See* Google Oct. 3, 2008 *Ex Parte* Letter at 1 (the definition of an assessable number should be "premised on a telephone number acting as a proxy for an underlying two-way PSTN connection"). As we explain herein, such a restriction is not warranted.

erse the PSTN is one of the causes in the erosion of the contribution base under the current revenue-based methodology. As more service providers migrate to alternative networks that partially access the PSTN, continuing to assess universal service contributions based only on traffic that exclusively traverses the PSTN will not account for this migration; nor will it allow us to meet our principle of competitive neutrality.[297] Moreover, if a service provider connects a private network to a public network, the service provider and its customers benefit from the connection to the PSTN. Because universal service supports the PSTN and these parties connect to the PSTN, they benefit from universal service.[298] Thus, it is increasingly important that we conform our regulatory definitions to recognize this reality. Indeed, the Commission has already begun to recognize the need to create a level regulatory playing field. For example, calls to end users that utilize interconnected VoIP service are not wholly within the PSTN. Indeed, calls between two interconnected VoIP users may not touch the PSTN at all. Yet we found in 2006 that interconnected VoIP providers must contribute to the universal service fund.[299] For these reasons, we conclude that our definition must account for public or private interstate networks, regardless of the technology of the network (e.g., circuit-switched, packet-switched) or the transmission medium of the network (e.g., wireline, wireless).

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[297] *Universal Service First Report and Order*, 12 FCC Rcd at 9207, paras. 845-46.

[298] *Universal Service First Report and Order*, 12 FCC Rcd at 9184 para. 796.

[299] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7536-37, paras. 33-34.

123. Finally, we recognize that, by declining to adopt for contribution purposes verbatim the definition of "assigned numbers" in section 52.15(f) of our rules, which is used by carriers to file NRUF reports,[300] we may nominally increase some of the administrative burden associated with universal service contribution filings. We find, however, that any minor administrative cost increases arising from not using the preexisting definition are outweighed by the benefits of modifying the definition to achieve sound universal service policy. For example, as stated above, the existing definition of assigned numbers would not enable us to meet our universal service contribution goal of ensuring that the provider with the retail relationship to the end user be the one responsible for contributing.[301]

124. Under our numbers-based approach, certain providers will be required to contribute to the universal service fund based on Assessable Numbers even though they are not today required to submit NRUF data. Section 52.15(f) of the Commission's rules requires only "reporting carriers" to submit NRUF data to the NANPA.[302] A "reporting carrier" is defined as a telecommunications carrier that receives numbering resources from the NANPA, the Pooling Administrator, or another telecommunications carrier.[303] In the case of numbers provided by a telecommunications carrier to a non-carrier entity, the carrier providing the numbers to such entities must report NRUF data to the NANPA for those numbers. Thus, non-carrier entities that use telephone num-

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[300] *See* 47 C.F.R. § 52.15(f)(iii).

[301] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844.

[302] 47 C.F.R. § 52.15(f).

[303] 47 C.F.R. § 52.15(f)(2).

bers in a manner that meets our definition of Assessable Numbers do not report NRUF data yet must contribute.[304] For example, interconnected VoIP providers may use telephone numbers that meet our definition of Assessable Numbers even though these providers do not report NRUF data.[305] These non-carrier entities that use numbers in a manner that meets our definition of Assessable Number will be required to determine their Assessable Number count based on their internal records (e.g., billing system records) and will be required to report such numbers to USAC.[306]

125. We are mindful that our move to a numbers-based contribution methodology may encourage entities to try to avoid their contribution obligations by developing ways to bypass the use of NANPA-issued numbers.[307] To the extent, however, these alternative methods are the functional equivalent of numbers and otherwise meet our definition of Assessable Numbers, such entities must

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[304] *NRO I Order*, 15 FCC Rcd at 7587, para. 21.

[305] *See Administration of the North American Numbering Plan, Order*, 20 FCC Rcd 2957, 2961-62, para. 9 (2005) (*SBCIS Waiver Order*) (noting that most VoIP providers' numbering utilization data are embedded in the NRUF data of the LEC). In the *SBCIS Waiver Order*, the Commission granted SBCIS, an Internet service provider, permission to obtain numbering resources directly from the NANPA and/or Pooling Administrator, conditioned on, among other things, SBCIS reporting NRUF data. *Id.* at 2959, para. 4.

[306] *See infra* paras. 147-53.

[307] *See* Letter from Jeanine Poltronieri, Vice President, Federal Regulatory, BellSouth D.C., Inc, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed July 6, 2005) ("If voice service is provided without using telephone numbers, but with IP address or other identifier, FCC will need to establish a 'functional equivalency' test.").

report these functional equivalents as Assessable Numbers to the universal service fund administrator.

3. Contribution Assessment Methodology for Business Services

126. Although we find that a numbers-based contribution mechanism is superior to the existing revenue-based mechanism for residential services, applying a numbers-based approach to business services would result in inequitable contribution obligations. Specifically, certain business services that do not utilize numbers, or that utilize them to a lesser extent, would not be contributing to the universal service fund on an equitable basis.[388] Section 254(d) of the Act requires "every carrier" that provides interstate telecommunications services to contribute to the universal service fund.[389] Thus, provid-

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[388] Business services such as private line and special access services do not typically utilize telephone numbers in the same manner as residential services, and would not contribute equitably to the universal service fund under a numbers-based approach. *See, e.g.*, Letter from James S. Blaszak, Counsel to Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 3 (filed Oct. 9, 2002); Letter from Robert Quinn, Vice President Federal Government Affairs, AT&T, to Marlene Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 2 (filed Oct. 22, 2002). Moreover, unlike residential services, which usually have one telephone number assigned per access line, business services do not usually have a number of telephone numbers assigned that aligns with the number of access lines utilized.

[389] 47 U.S.C. § 254(d). Therefore, we disagree with those parties that continue to support a numbers-only based approach because we find such an approach would be inconsistent with the statutory requirement that every telecommunications carrier must contribute to the universal service fund. *See, e.g.*, Letter from James S. Blaszak, Counsel for Ad Hoc, to Marlene H. Dortch, Secretary, FCC, CC

ers of business services, including non-numbers based services, must continue to contribute. We conclude that these services should be assessed based on their connection to the public network.

127. A number of commenters supported moving to a methodology that would assess telephone numbers for those services that are associated with a telephone number and assess based on capacity of the connection to the public switched network those services not associated with a telephone number.[310] Other commenters supported retaining a revenue based methodology for these services.[311] As discussed above, a revenue-based contribution methodology is no longer sustainable in today's telecommunications marketplace.[312] Additionally, a connections-based contribution methodology will provide a basis for assessing services not associated with telephone numbers, and will recognize the greater utility derived by business end users from these high capacity business service offerings.[313] Further, in contrast to the revenues on which contributions are currently based, the number and capacity of connections continues to grow over time,

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Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 07-135, Attach. at 5 (filed Oct. 14, 2008).

[310] *See Staff Study*; *see also* Ad Hoc Telecommunications Users Committee 2003 Staff Study Reply; Letter from John Nakahata, Counsel for the Coalition for Sustainable Universal Service, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Oct. 31, 2002).

[311] *See* Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 6 (filed Mar. 21, 2006) (Qwest Mar. 21, 2006 *Ex Parte* Letter); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 2.

[312] *See supra* para. 97.

[313] Time Warner *2006 Contribution FNPRM* Comments at 2.

providing a contribution base that is more stable than the current revenue-based methodology. Moreover, a connections-based mechanism can be easily applied to all business services. We, therefore, conclude that a connections-based contribution mechanism is the better option for business services. We seek comment below on the implementation of the connections-based contribution mechanism for business services.[314]

128. We find that it is equitable and nondiscriminatory, consistent with the requirements of section 254(d) of the Act, to establish different contribution methodologies for residential and business services.[316] Although the statute states that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service," it does not require that all contributors or all services be assessed in the same manner.[317] Under the current revenue-based mechanism, the Commission has established different contribution methodologies through the use of proxies for wireless and interconnected VoIP services.[317] As noted above,

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[314] We decline at this time to adopt AT&T and Verizon's proposal for assessing contributions on connections based on flat rate charges that would differ based on the speed of the connection. AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 2. Instead, we seek further comment on implementing assessments based on connections.

[316] 47 U.S.C. § 254(d).

[317] 47 U.S.C. § 254(b)(4).

[317] The proxies offer an alternative to contributions assessed on actual interstate revenues; they are intended to approximate the portion of revenues derived from the provision of interstate telecommunications services. *First Wireless Safe Harbor Order*, 13 FCC Rcd at 21258-60, paras. 13-15 (establishing safe harbors for wireless service providers); *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 14954, para. 1 (modifying the wireless safe harbors); *2006 Interim*

continuing to use a revenues-based contribution methodology has become increasingly complex, and a numbers-based system would avoid many of those complexities.[318] At the same time, however, if we relied exclusively on a numbers-based contribution methodology, there are some business services—such as private line and special access—that would escape contribution requirements entirely. That result would be inconsistent with the obligation that all providers of interstate telecommunications services contribute to universal service, and would impose an unfair burden on providers that contribute on the basis of numbers.[319] We therefore conclude that adopting different contribution assessment methodologies for residential and business services will result in equitable and nondiscriminatory contribution obligations.

129. On an interim basis, while we conduct a proceeding to implement the connections-based contribution methodology, we continue to require providers to contribute to the universal service fund using the current revenue-based methodology for their business services.[320] We find that providers of business services should continue to bear their portion of the universal service contri-

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Contribution Methodology Order, 21 FCC Rcd at 7532, 7545, paras. 23, 53 (revising the wireless safe harbor and establishing a safe harbor for interconnected VoIP providers).

[318] *See supra* para. 95.

[319] 47 U.S.C. §§ 254(b)(4), (d).

[320] Contributors will base their contributions on business service revenues in the same manner as they do currently. We make no change to the *de minimis* exemption or to the Limited International Revenue Exception (LIRE) for business contributions based on revenues. 47 U.S.C. § 254(d); 47 C.F.R. § 54.708; *Fifth Circuit Remand Order*, 15 FCC Rcd at 1687-88, para. 19; *Contribution First FNPRM*, 17 FCC Rcd at 3806-07, paras. 125-28. These exceptions do not apply to residential contributions based on numbers.

bution obligation to ensure the sufficiency of the fund while the connections-based contribution mechanism is being implemented.[321]

130. During the interim period in which the revenue-based contribution assessment for business services remains in place, the contribution factor for providers of business services will be determined based on the funding requirements not covered by the $1.00 assessment on Assessable Numbers. We will hold constant the contribution assessment on Assessable Numbers and determine the revenue contribution factor based on the quarterly projected demand of the universal service mechanisms divided by the quarterly projected-collected interstate and international end user telecommunications revenues from business services in the same manner in

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[321] *See* 47 U.S.C. § 254(d). Prepaid calling card providers, as well as any other current contributors who provide services to residential consumers but do not assign Assessable Numbers, shall continue to contribute based on their revenues during the interim period until these business services are assessed on the basis of connections and/or numbers. Despite IDT's recent request that its prepaid calling card services be treated as residential for purposes of universal service contribution assessments, we find that, consistent with arguments made over the years by such providers, these calling card services are provided to businesses. *See* Request for Review of Decision of the Universal Service Administrator by IDT Corporation and IDT Telecom, CC Docket No. 96-45 at 3 (filed June 30, 2008) ("The vast majority of [prepaid calling card sales] are completed through a network of distributors and resellers before being purchased by the ultimate end user consumer."). *But see* Letter from Tamar E. Finn, Counsel, IDT Corporation, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 (filed Oct. 28, 2008) (asking the Commission to treat prepaid calling cards as residential services if the Commission adopts a numbers-based methodology limited to residential numbers).

which the current contribution factor is calculated.[322] This approach will ensure a specific, predictable, and sufficient funding source for the Commission's universal service mechanisms.

4. Wireless Prepaid Plans

131. We adopt an alternative methodology for telephone numbers assigned to handsets under a wireless prepaid plan. Some commenters assess prepaid wireless services on a per-minute-of-use basis.[323] For example, prepaid wireless providers argue that their customers are typically low-income or low-volume consumers and, as such, should be subject to a lesser assessment.[324] Verizon and TracFone further assert that prepaid wireless providers may have difficulty administering a per-number assessment.[325] Verizon, therefore, recommends that any new contribution methodology accommodate prepaid wireless service providers by adopting a per-number assessment that "reflects the unique characteris-

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[322] The Commission may revise the specific per-number residential assessment amount in the future, if market conditions warrant.

[323] AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 4.

[324] Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed Sept. 17, 2008) (TracFone Sept. 17, 2008 *Ex Parte* Letter); CTIA *2006 Contribution FNPRM* Comments at 6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 3-4; Letter from John M. Beahn and Malcolm Tuesley, Counsel to Virgin Mobile USA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 4-7 (filed June 12, 2006) (Virgin Mobile June 12, 2006 *Ex Parte* Letter).

[325] *See, e.g.*, Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 2; Virgin Mobile June 12, 2006 *Ex Parte* Letter, Attach. at 7.

tics of [the] service," and TracFone similarly agrees.[326] Finally, CTIA essentially argues that the sheer number of prepaid wireless end users—over 44 million—combined with the likelihood that most of these end users would see a rise in their pass-through assessments warrants an exception.[327]

132. To accommodate the unique situation of prepaid wireless service providers, we find it appropriate to create a limited modification in contribution assessments for providers of prepaid wireless services and their end users.[328] We agree with commenters that it is considerably more difficult for wireless prepaid providers to pass-through their contribution assessments in light of their "pay-as-you-go" service offerings.[329] Because of this significant practical issue, we will modify the numbers-based assessment for prepaid wireless providers with regard to their offering of these services. Further, we note that, just as with Lifeline customers, many prepaid wireless end users are low income consumers. For example,

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[326] *See* Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach.; *see also* Letter from Antoinette Bush, Counsel for Virgin Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 11 (filed Mar. 18, 2005) (Virgin Mobile Mar. 18, 2005 *Ex Parte* Letter); AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter at 6.

[327] *See* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1 (raising a concern that current proposals could harm the large number of prepaid wireless customers).

[328] *See supra* para. 141.

[329] *See* Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 3 (filed June 15, 2007) (TracFone June 15 *Ex Parte* Letter).

TracFone states that about half of its customers have incomes of $25,000 or less.[330]

133. We find that TracFone's "USF by the Minute" proposal best addresses the concerns of prepaid wireless providers within the context of the new numbers-based contribution methodology we adopt today.[331] TracFone's proposed USF by the Minute Plan would calculate universal service contribution assessments on prepaid wireless services by dividing the residential per-number assessment (the $1.00 flat fee adopted above) by the number of minutes used by the average postpaid wireless customer in a month. This per-minute number would then be multiplied by the number of monthly prepaid minutes generated by the provider. This amount would be the provider's monthly universal service contribution obligation. The per-minute assessment, however, would be capped at an amount equal to the current per month contribution per Assessable Number, the per-number assessment amount adopted above.[332] We illustrate the proposal below.

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[330] TracFone June 15, 2007 *Ex Parte* Letter at 3. TracFone also asserts that an exception is warranted because it provides service to low volume end users (i.e., end users that do make a small amount of calls, measured in minutes). *Id.* However, as explained below, we decline to provide a contribution exception for low volume users. *See infra* para. 143.

[331] AT&T and Verizon support the TracFone discount approach for prepaid wireless providers. AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 3; *see also* Letter from David L. Sieradzki, Counsel to OnStar Corp., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (dated Oct. 28, 2008) (OnStar "strongly supports" the TracFone per-minute of use proposal for prepaid wireless services) (OnStar Oct. 28, 2008 *Ex Parte* Letter).

[332] TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 4-5.

134. According to CTIA data submitted by TracFone, the average wireless postpaid customer used 826 minutes per month for the period ending December 2007.[333] The residential per-number assessment of $1.00 would be divided by 826 minutes to calculate a per-minute assessment of $0.001210654. The wireless prepaid provider's contribution obligation would be calculated by multiplying the per-minute assessment by the number of prepaid minutes generated for the month. If the wireless prepaid provider generated a billion prepaid minutes in a month, its contribution for that month would be $1,210,654.[334] If the prepaid provider had 10 million prepaid customers that month, the average contribution per customer would be $0.12 and its contribution obligation would remain at $1,210,654. If, on the other hand, it had only 1 million customers, the average contribution per-customer would be $1.20, which exceeds the residential per-number assessment of $1.00. In this case, because the per-customer contribution amount under the calculation would exceed the residential per-number assessment established by the Commission, the prepaid provider's contribution obligation would be capped at $1,000,000, which is the residential per-number assessment of $1.00 multiplied by the 1 million monthly prepaid customers. Under this scenario, the average per-customer contribution for the prepaid wireless provider would be equal to the per-number contribution of $1.00 for non-prepaid residential numbers.

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[333] *See* TracFone Sept. 17, 2008 *Ex Parte* Letter at 5. We use these data because they are the most recent publicly available data.

[334] To the extent that the prepaid wireless subscriber is a Lifeline customer for the prepaid service, the prepaid provider should exclude prepaid minutes associated with the qualifying Lifeline customer. *See infra* para. 141.

135. We find the TracFone discount approach superior to other forms of a discount proposed by parties. For example, CTIA proposed a fifty percent discount for prepaid wireless providers.[335] The TracFone approach is based on actual wireless calling data, whereas the CTIA approach represents a more arbitrary half-off discount. Moreover, the CTIA proposal makes no allowance for the type of end user that is using the prepaid wireless service. This contrasts with the TracFone proposal, which would not provide any discount to those end users that use more than the average monthly post-paid number of minutes. As explained above, for those customers whose usage would result in more than the $1.00 pass-through, the assessment on the provider and the pass-through would be capped at $1.00 per month per Assessable Number. Thus, high volume users would neither benefit from, nor be penalized by, the discount mechanism. Finally, we make clear that if the prepaid provider is an ETC and is providing service to qualifying Lifeline customers, the provider is exempt from contribution assessments on the qualifying Lifeline customers and we prohibit the provider from assessing any universal service pass-through charges on their Lifeline customers.

5. Exceptions to Contribution Obligations

136. A number of parties have asked for exceptions from the contribution obligation. We find that, in general, providing an exception or exemption to a particular provider or to a particular category of end users would complicate the administration of the numbers-based methodology we adopt today. The result would unfairly favor certain groups by reducing or eliminating their contribution obligations, while increasing the contribu-

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[335] CTIA Oct. 2, 2008 *Ex Parte* Letter at 5.

tion obligations on providers that are not exempted from contributing. Therefore, we conclude that grant of an exemption from the contribution obligations is only warranted for those who are truly unable to bear the burden of contributing to the universal service fund—low-income consumers. As discussed below, we exempt providers from contribution assessments on their qualifying Lifeline program customers and prohibit contributors from assessing any universal service pass-through charges on their Lifeline customers. As explained below, an exception for low-income consumers is consistent with the Commission's policies underlying the low-income universal service program and targets universal service benefits to those consumers most in need of those benefits.[336]

137. We conclude that telephone numbers assigned to Lifeline customers should be excluded from the universal service contribution base and providers of Lifeline service may not pass-through contribution assessments to Lifeline customers.[337] The Lifeline program provides an opportunity for the Commission to ensure that low-income families are not denied access to telephone service. We find that an exception for Lifeline customers satisfies the high threshold necessary to justify an exception to the new numbers-based contribution methodology we adopt today. Lifeline customers are, by definition, among the poorest individuals in the country. As such, they are in the greatest need of relief from regulatory assessments. Prohibiting recovery of universal service contributions from Lifeline customers helps to increase subscribership by reducing qualifying low-income con-

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[336] *Alenco v. FCC*, 201 F.3d at 621.

[337] *See, e.g.*, AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 4 (proposing that numbers assigned to Lifeline customers be excluded from the monthly number count for contribution purposes).

sumers' monthly basic local service charges.[338] The record, moreover, overwhelmingly supports the creation of an exception for Lifeline customers. Consumer groups, large telecommunications customers, LECs, and wireless providers all support creating an exemption for Lifeline customers, and no commenter opposes an exemption for Lifeline customers.[339] We therefore adopt an exemption to our numbers-based contribution methodology for Lifeline customers. Although commenters have sought contribution exceptions for other groups of consumers or service providers, we decline to adopt any further exceptions.[340] Some parties argue that consumers who make few or no calls, i.e., low-volume users, should be exempt from the numbers-based residential contribution assessment mechanism.[341] As discussed above, all users of the network, even those who make few or no calls, receive a benefit by being able to receive calls, and therefore it is appropriate for these consumers to contribute to universal service.[342] Also as discussed above, to the extent low-

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[338] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24982, para. 62.

[339] *See, e.g.*, CTIA *2006 Contribution FNPRM* Comments at 5; CU et al. *High-Cost Reform NPRMs* Reply at 58; Ad Hoc Nov. 19, 2007 *Ex Parte* Letter at 4; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 5.

[340] We do not prejudge whether additional exceptions should apply if the Commission were to assess contributions based on numbers for business services. We note that certain businesses, such as nonprofit health care providers, libraries, and colleges and universities, support such exemptions. We do not address those exemptions at this time.

[341] *See, e.g.*, CU et al. *Contribution First FNPRM* Comments at 12; NASUCA *Contribution First FNPRM* Comments at 14; Keep USF Fair Mar. 27, 2006 *Ex Parte* Letter, Attach. at 1.

[342] *See supra* para. 113; *see also* Sprint *Contribution First FNPRM* Comments at 7.

volume consumers may see an increase in the amount of their universal service contribution pass-through fee,[343] any such increase should be slight.[344]

139. We also decline to exempt telematics providers,[345] stand-alone voice mail providers,[346] one-way service providers,[347] and two-way paging services[348] from contributing based on numbers. We disagree with commenters

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[343] *But see* IDT Aug. 2, 2007 *Ex Parte* Letter at 6-7 (arguing that low-volume consumers who make no long distance calls pay about $1.40 in universal service contribution assessments).

[344] *See supra* para. 112.

[345] Telematics is a service that is provided through a transceiver, which is usually built into a vehicle but can also be a handheld device, that provides public safety information to public safety answering points (PSAPs) using global positioning satellite data to provide location information regarding accidents, airbag deployments, and other emergencies in real time. *See, e.g.*, Letter from David L Sieradzki, Counsel for OnStar, to Marlene H. Dortch, FCC, CC Docket No. 96-45, Attach. at 1 (filed Mar. 2, 2006); *Revision of the Commission's Rules To Ensure Compatf i]bility with Enhanced 911 Emergency Systems*, CC Docket No. 94-102, Order, 18 FCC Rcd 21531, 21531-33, paras. 2, 8 (2003).

[346] Letter from Jennifer D. Brandon, Executive Director, Community Voice Mail National, to Tom Navin, Wireline Competition Bureau, FCC, CC Docket No. 96-45 at 1 (filed May 30, 2006) (Community Voice Mail May 30, 2006 *Ex Parte* Letter) (arguing for an exemption for these services).

[347] One-way services include, but are not limited to, one-way paging, electronic facsimile (e-fax), and voicemail services (other than stand-alone voicemail services, as discussed above).

[348] *See, e.g.*, Letter from Matthew Brill, Counsel for USA Mobility, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (filed Oct. 24, 2008) (opposing the assessment of a numbers-based fee on paging carriers and their customers); Letter from Kenneth Hardman, representing the American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at Attach. (filed Oct. 22, 2008).

arguing for special treatment for these services.[349] Granting exceptions for these services would provide them with an advantage over other services that are required to contribute based on residential telephone numbers. These services are receiving the benefit of accessing the public network and therefore assessing universal service contributions on these entities is appropriate.[350] These service providers have not shown that grant of a contribution exception is warranted.[351] Accordingly, providers

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[349] *See* Letter from Ari Q. Fitzgerald, Counsel, Mercedes-Benz USA, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Apr. 12, 2006) (Mercedes-Benz Apr. 12, 2006 *Ex Parte* Letter); *see also* Letter from John E. Logan, ATX Group, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 2 (filed Mar. 16, 2006) (ATX Mar. 16, 2006 *Ex Parte* Letter); Letter from David M. Don, Counsel for j2 Global Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Nov. 18, 2005) (j2 Global Nov. 18, 2005 *Ex Parte* Letter); Letter from William B. Wilhelm, Jr., Counsel for Bonfire Holdings, to Tom Navin, Chief, Wireline Competition Bureau, CC Docket No. 96-45 (filed Feb. 13, 2006) (Bonfire Feb. 13, 2006 *Ex Parte* Letter); j2 Global *Contribution Second FNPRM* Comments at 2; Letter from Kenneth E. Hardman, Counsel for American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1 (filed Oct. 6, 2005) (AAPC Oct. 6, 2005 *Ex Parte* Letter); Letter from Frederick M. Joyce, Counsel for USA Mobility, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1-3 (filed Mar. 22, 2006) (USA Mobility Mar. 22, 2006 *Ex Parte* Letter).

[350] We similarly decline to adopt an exemption from the numbers-based contribution assessment method for services provided by alarm companies. *See* Letter from Donald J. Evans, Counsel for Corr Wireless Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 06-122, WT Docket No. 05-194, at 2 (filed Oct. 23, 2008). These services are receiving the benefit of having access to the PSTN and should therefore contribute to universal service.

[351] Telematics providers argue against imposition of a $1.00 per number per month contribution assessment on telematics numbers

of these services will be assessed the full per-number charge. Some one-way service providers argue that their services are currently offered on a free, or nearly-free basis, and if these services are assessed on a per telephone number basis, providers will no longer be able to offer them.[352] We disagree that our change in contribution policy necessitates this result. Although these services may be marketed as "free" to the end user, these services are not truly free. Commercial providers of free or nearly-free services generate revenue in other ways, such as advertising or through more sophisticated paid

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due to the service's critical role in advancing public safety, and because the $1.00 assessment would be prohibitively expensive. *See, e.g.*, Letter from Gary Wallace, Vice President Corporate Relations, ATX Group, Inc., to Kevin Martin, Chairman, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 1-2 (filed Oct. 28, 2008); OnStar Oct. 28, 2008 *Ex Parte* Letter at 3-4; Letter from Matthew Brill, Counsel for Toyota Motor Sales USA, Inc., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1-2 (filed Oct. 24, 2008). We find, however, that treating these services differently than other residential services would not be equitable, given their use of the PSTN and the ability of telematics providers to recover the assessment from their end users. Given the public safety benefit to consumers, we find unpersuasive the telematics' providers assertions that consumers will discontinue use of the service based on an assessment of only $1.00 per number. Furthermore, we disagree with commenters who argue that telematics service should be treated as a business service, and conclude that telematics service is a residential service that should be assessed under the $1.00 per number per month residential contribution methodology. *See* OnStar Oct. 28, 2008 *Ex Parte* Letter at 2; Letter from Tamara Preiss, Legal and External Affairs, Verizon Wireless, to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1 (filed Oct. 29, 2008).

[352] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 7 (arguing that a connections-based universal service methodology would force many heavily used one way communications services out of existence).

service offerings or product offerings, and, therefore, whether they continue to offer free services would be a business decision based upon the circumstances of the particular business.[353] Indeed, we find that assessing a per-number contribution obligation on these services is consistent with our determination that services that benefit from a ubiquitous public network are fairly charged with supporting the network.

140. We also decline to adopt an exception from the residential numbers-based contribution mechanism for additional handsets provided through a wireless family plan. We do not agree with commenters who argue that telephone numbers assigned to the additional handsets in family wireless plans should be assessed at a reduced rate, either permanently or for a transitional period.[354] These commenters assert that assessing contributions at the full per-number rate would cause family plan customers to experience "rate shock."[355] Although family plan customers may see an increase in universal service contribution pass-through charges on their monthly bills, we are not persuaded that the fear of "rate shock" justifies special treatment. We find that each number associated with a family plan obtains the full benefits of accessing the public network, and thus it is fair to assess each

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[353] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 8 (describing a "free" service supported by advertising revenue).

[354] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter at 4; CTIA *2006 Contribution FNPRM* Comments at 5-6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2.

[355] *E.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 4; CTIA *2006 Contribution FNPRM* Comments at 5-6; Leap Wireless *2006 Contribution FNPRM* Comments at 2-3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2-3. *But see* AAPC Oct. 9, 2008 *Ex Parte* Letter at 2.

number with a separate contribution obligation. We also note that wireless service is one of the fastest-growing sectors of the industry and the record does not include persuasive data showing that a move to a numbers based contribution methodology would have a significant, detrimental impact on wireless subscribership.[366] We agree with Qwest that an exception for additional family plan handsets would not be competitively neutral and would advantage approximately 70 million wireless family plan consumers over other residential service consumers.[367] Multiple wireline lines in a household are not given a discounted contribution assessment rate. We therefore decline to adopt a reduced assessment for wireless family plan numbers.

141. Some parties seek an exception to the contribution methodology we adopt today to exclude Internet-based telecommunications relay services (TRS), including video relay services (VRS) and IP Relay services.[368] We decline to adopt an exception for such providers at this time. The Commission has an open proceeding on a

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[366] There are, as of December 2007, 249,235,715 mobile wireless subscribers, a more than 9% increase from the previous year. *See* FCC, LOCAL TELEPHONE COMPETITION: STATUS AS OF DECEMBER 31, 2007, tbl. 14 at 18 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-285509A1.pdf. Moreover, where a wireless provider is eligible to receive universal service support, it receives the same level of support for each handset. *See* WTA/OPASTCO/ITTA Oct. 10, 2008 *Ex Parte* Letter at 2.

[367] Qwest Sept. 24, 2008 *Ex Parte* Letter, Attach. at 7; Qwest May 4, 2006 *Ex Parte* Letter, Attach. at 9; *see also* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1.

[368] *See* Letter from Deb MacLean, Communication Access Center for the Deaf and Hard of Hearing, et al. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 98-45, at 1-2 (filed Sept. 29, 2008) (CSDVRS Sept. 29, 2008 *Ex Parte* Letter).

number of issues related to these providers, including whether certain costs to these providers related to the acquisition of ten-digit numbers by their customers should be reimbursed by the TRS fund.[359] We defer to that proceeding consideration of whether to adopt an exception to the contribution methodology we adopt today for numbers assigned to Internet-based TRS users.[360]

6. Reporting Requirements and Recordkeeping

142. Under the existing revenue-based contribution methodology, contributors report their historical gross-billed, projected gross-billed, and projected collected end-user interstate and international revenues quarterly on the FCC Form 499-Q and their gross-billed and actual collected end-user interstate and international revenues

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[359] *See Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, CG Docket No. 03-123, WC Docket No. 05-196, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 11591, 11646, para. 149 (2008) ("We . . . seek comment on whether, and to what extent, the costs of acquiring numbers, including porting fees, should be passed on to the Internet-based TRS users, and not paid for by the [TRS] Fund. . . . We also seek comment on whether there are other specific costs that result from the requirements adopted in the *Order* that, mirroring voice telephone consumers, should be passed on to consumers, including, for example, E911 charges.").

[360] To the extent that Internet-based TRS users utilize a proxy number or identifier other than an assigned ten-digit number during/pending the transition to ten-digit numbering for Internet-based TRS services, we make clear that those numbers or identifiers are NOT subject to universal service contribution at this time. This treatment is necessary to ensure the smooth transition to ten-digit numbering for these services, and to prevent duplicative charges for end users of these services.

annually on the FCC Form 499-A.[361] Contributors are billed for their universal service contribution obligations on a monthly basis based on their quarterly projected collected revenue.[362] Actual revenues reported on the FCC Form 499-A are used to perform true-ups to the quarterly projected revenue data.[363]

143. We will develop a new and unified reporting system to accommodate our new universal service contribution methodology.[364] Contributors will report their Assessable Number counts on a monthly basis. Contributors must report as an Assessable Number any such number that is in use by an end user during any point in the relevant month. The Commission will develop an ad-

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[361] *See, e.g., Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969, para. 29. Filers are required to file revisions to FCC Form 499-Q within 45 calendar days of the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499-Q, at 10 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-Q/499q.pdf. Filers are required to file revisions to FCC Form 499-A by March 31 of the year after the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499-A, at 11-12 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-A/499a-2008.pdf.

[362] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 35.

[363] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 36.

[364] We decline to adopt the suggestion by AT&T and Verizon to transition the Telecommunications Relay Services Fund, local number portability cost recovery, and numbering administration to a numbers/connections-based assessment methodology. *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 6. Although these programs rely on the revenue information reported in the current FCC Form 499-A, they do not rely on many of the revenue distinctions, such as interstate and intrastate, that necessitate the change from a revenue-based assessment for the universal service fund.

ditional version of the FCC Form 499 for use in reporting Assessable Numbers. Under the interim business revenue-based reporting component, contributors will report their revenue information on the modified FCC Forms 499-A and 499-Q.

144. Under the new numbers-based system we adopt today, contributors will report historical Assessable Numbers monthly. Contributors will then be invoiced and required to contribute the following month. By reporting actual, historical numbers, the numbers-based component of our contribution methodology remains simple and straightforward. As explained above, a key reason to move to a primarily numbers-based approach is its simplicity. Indeed, several commenters propose monthly reporting of historical number counts.[355] We find that reporting Assessable Numbers on a projected collected basis would unnecessarily complicate the numbers-reporting system. Although we are mindful of the issues inherent in historical reporting,[356] we find that a one month lag between the reported Assessable Numbers and the contribution based on those numbers is minimal and will not unfairly disadvantage any provider, even those with a declining base.

145. We allow contributors to self-certify which telephone numbers are, consistent with this order, considered "residential." Contributors will be subject to audit, however, and their method for distinguishing residential from other numbers must be reasonable and supportable. For example, in the Commission's *Broadband Data*

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[355] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 2-3; CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 5; USF by the Numbers Oct. 3, 2008 *Ex Parte* Letter.

[356] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969-70, paras. 29-32.

Gathering Order released earlier this year, the Commission directed mobile wireless service providers "to report as residential subscriptions those subscriptions that are not billed to a corporate account, to a non-corporate business customer account, or to a government or institutional account."[367] We added that "[f]or purposes of Form 477, subscriptions billed to a federal government department or agency, for example, will not be 'residential' subscriptions, while subscriptions to a service plan offered to all federal government employees will be considered to be residential subscriptions."[368] For purposes of identifying numbers associated with business services (which are not Assessable Numbers), contributors may rely on the fact that the line associated with that number is assessed a *multi-line* end user common line charge (i.e., SLC); provided, however, that the SLC must be a mandatory charge, rather than a discretionary charge.[369] For determining residential numbers (which are Assessable Numbers), however, a contributor may not rely on the assessment of a residential SLC, because SLC rates are the same for residential and single-line business end

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[367] *Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, 23 FCC Rcd 9691, 9704, para. 24 (2008) (*Broadband Data Gathering Order*), Order on Reconsideration, 23 FCC Rcd 9800 (2008).

[368] *Broadband Data Gathering Order* at para. 24 n.91.

[369] In other words, the SLC type and rate must be established pursuant to the Commission's rules. 47 C.F.R. §§ 69.104(o)(1), 69.152(k)(1). To the extent that the contributor is not required to charge a SLC (e.g., is not rate-regulated by the Commission), a voluntary business choice to include a "subscriber line charge" on a customer's bill may not be dispositive of the type of service, residential or business, being provided.

users. Therefore, the fact that a contributor charges the single-line business/residential SLC may not accurately indicate whether the service provided is a business or residential service.[370]

146. Each contributor must maintain the necessary internal records to justify, in response to an audit or otherwise, its reported Assessable Number counts and the data reported on the Commission's contribution forms.[371] Contributors are responsible for accurately including all Assessable Numbers associated with residential services in their Assessable Number counts and revenues from all business services in the interim business services revenue component of the methodology. Failure to file the required form by the applicable deadline, or failure to file accurate information on the form, could subject a contributor to enforcement action.[372] In addition, as with the current FCC Forms 499-A and 499-Q, we will require that an officer of the filer certify to the truthfulness and accuracy of the forms submitted to the administrator.

147. To ensure that filers report correct information, we continue to require all reporting entities to maintain records and documentation to justify the information reported in these forms, and to provide such records and documentation to the Commission and to USAC upon request.[373] All universal service fund contributors are re-

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[370] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1).

[371] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 27.

[372] Pursuant to section 1.80 of the Commission's rules, failure to file required forms or information carries a base forfeiture amount of $3,000 per instance and is subject to adjustment criteria. *See* 47 C.F.R. § 1.80.

[373] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; *see also* 47 C.F.R. §§ 54.706(e), 54.711(a).

quired to retain their records for five years.[374] Specifically, contributors to the universal service fund must retain all documents and records that they may require to demonstrate to auditors that their contributions were made in compliance with the program rules, assuming that the audits are conducted within five years of such contribution. Contributors further must make available all documents and records that pertain to them, including those of contractors and consultants working on their behalf, to the Office of Inspector General, to USAC, and to their respective auditors. These documents and records should include without limitation the following: financial statements and supporting documentation; accounting records; historical customer records; general ledgers; and any other relevant documentation.[375]

148. Further, we make clear that for purposes of the interim business revenue component, we retain all existing reporting requirements associated with the filing of the FCC Forms 499-A and 499-Q for business service revenue. Finally, we direct the Bureau, and delegate to the Bureau the authority, to develop or modify the necessary forms to ensure proper contribution reporting occurs, consistent with this order.

7. Transition to New Methodology

149. The new reporting procedures discussed above will require reporting entities to adjust their record-keeping and reporting systems in order to provide re-

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[374] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; 47 C.F.R. § 54.706(e).

[375] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, paras. 27-28. We note that contributors who also report NRUF data to the NANPA are currently required to maintain internal records of their numbering resources for audit purposes. *NRO I Order*, 15 FCC Rcd at 7601, para. 62.

ports to USAC regarding the number of Assessable Numbers and to adjust their revenue information to include only business service revenue. Accordingly, we implement a 12-month transition period for the new contribution mechanisms.[376] This transition period will give contributors ample time to adjust their record-keeping and reporting systems so that they may comply with modified reporting procedures. As explained below, a 12-month transition period will also allow reporting entities to submit several reports for informational purposes before being assessed on the basis of projected Assessable Numbers for residential services.[377] We find, therefore, that a 12-month transition period balances administrative burdens on contributors with the need to implement the new contribution methodologies in a balanced and equitable manner.

150. During 2009, filers will continue reporting their interstate telecommunications revenue on a quarterly basis and USAC will continue assessing contributions to the federal universal service mechanisms based on those quarterly reports. This one-year period and, in particu-

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[376] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (proposing a 12-month transition to the new mechanism taking effect).

[377] *See* CTIA *2006 Contribution FNPRM* Comments at 7; *see also* Verizon and AT&T Sept. 11, 2008 *Ex Parte* Letter, Attach. at 2 (advocating a 12-month implementation period followed by a 6-month transition period). Some parties advocated for a transition period as short as possible. *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, Attach. at 2 (filed Sept. 19 2008) (CenturyTel Sept. 19, 2008 *Ex Parte* Letter); Sprint Nextel June 14, 2006 *Ex Parte* Letter. Others advocated for a longer transition period. *See, e.g.*, Qwest Mar. 21, 2006 *Ex Parte* Letter, Attach. at 3 (advocating 18 months); XO Communications Oct. 3, 2008 *Ex Parte* Letter, Attach. at 11 (advocating at least 18 months).

lar, the first six months of that period, should be used by contributors to adjust their internal and reporting systems to prepare for the reporting of Assessable Numbers and business revenues.

151. Beginning in July 2009, contributors will continue to report and contribute based on their quarterly reported interstate and international revenues for the last two quarters of the year, but they will also begin filing with USAC monthly reports of their Assessable Numbers and quarterly reports of their business revenues. USAC will thus collect data under the old revenue-based methodology, while collecting and reviewing data under the new Assessable Number and business revenues methodologies for the last six months of 2009. We find that this six-month period of double-reporting is necessary to help reporting entities, Commission staff, and USAC identify implementation issues that may arise under this new methodology prior to it taking effect.[378] Although only the December 2009 Assessable Numbers and the fourth quarter 2009 business revenue data will be used to compute contributors' January 2010 and first quarter 2010 assessments, we find it is reasonable to require contributors to begin filing under the new methodologies prior to these periods to ensure that there is adequate time for all affected parties to address any implementation issues that may arise. Moreover, we conclude that the short overlap of reporting under both the old and new methodologies will not be unduly burdensome for contributors given the limited duration of the dual reporting.

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[378] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (recommending a six-month transition period for filers and USAC to test and calibrate the new system prior to its taking effect).

V. REFORM OF INTERCARRIER COMPENSATION

152. Since Congress first passed the Communications Act in 1934, the Commission has sought "to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[379] To promote universal service, regulators have long relied on a complex array of intercarrier compensation mechanisms, which generally have included implicit subsidies. Through the years, the introduction of competition into first long-distance and then local markets, as well as the development and deployment of new technologies, have eroded the fundamental economic underpinnings of the current intercarrier compensation regimes. The reforms we adopt in this order are designed to unify and simplify the myriad intercarrier compensation systems in existence today. This unification and simplification will encourage the efficient use of, and investment in, advanced telecommunications and broadband networks, spur intermodal competition throughout the United States, and minimize the need for future regulatory intervention.

153. Today, we adopt a new approach to intercarrier compensation and establish the blueprint for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we recognize, as the Commission has in the past, that we need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation re-

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[379] 47 U.S.C. § 151.

gimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan, with separate stages, designed to reduce rates over a sufficient period to minimize market disruptions and to cushion the impact of our reform on both customers and carriers. At the end of the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

A. A Brief History of Intercarrier Compensation

154. This section provides an overview of the development of intercarrier compensation regulation in the United States. Although not comprehensive, it highlights several important goals that have emerged in Commission precedent, which are relevant to intercarrier compensation reform.

- *Promoting universal service.* The Commission has sought to promote universal service, and, in furtherance of that objective, an intricate web of implicit subsidies evolved that were intended to keep the price of residential local telephone service affordable, even if that price was below cost. With the introduction of competition for long-distance telephone service, regulators sought to maintain implicit subsidies of local service when they created regulated intercarrier compensation charges, known as "access charges," that long-distance service providers paid local telephone companies to originate and terminate long-distance calls.

- *Encouraging efficient use of the network.* The Commission has long recognized that requiring end-users to bear a greater proportion of the cost of the local network encourages them to make rational choices in their use of telephone service. The Commission nevertheless has declined to shift a significant percentage of the cost of the network to those end users in light of universal service concerns.
- *Realigning cost recovery in response to competition.* For much of the twentieth century, telephone service was viewed as a natural monopoly. The emergence of competition for long-distance services in the 1970s and for local services, particularly after the 1996 Act, has placed pressure on above-cost intercarrier compensation charges. Although the Commission, in response to competitive entry, sought to develop intercarrier compensation rules that align more closely with the economic principle that costs should be recovered in the way they are incurred, marketplace developments confirm that those efforts were incomplete. As new competitors entered, a series of regulatory arbitrage strategies developed, some of which the Commission has attempted to address on a case-by-case basis.
- *Technological advancements.* As carriers shift from circuit-switched telephone-only networks to packet-switched broadband networks supporting numerous services and applications, it is important that intercarrier compensation rules create the proper incentives for carriers to invest in new broadband technology and

that consumers have the opportunity to take full advantage of the new capabilities of this broadband world.

1. Intercarrier Compensation Regulation Before the Telecommunications Act of 1996

155. When AT&T began offering telephone service in 1877,[380] it held all the essential patents and effectively operated as a legal monopoly. When the original patents expired in 1894, however, thousands of independent telephone companies began offering competing local telephone service.[381] This new competition led to lower rates,[382] and reduced AT&T's average return on investments by over 80 percent.[383] AT&T responded by refus-

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[380] The company that became AT&T was originally called the Bell Telephone Company. *See* AT&T, A Brief History: Origins, http://www.corp.att.com/history/history1.html (last visited Sept. 11, 2008) (AT&T Brief History). For simplicity, we use the term "AT&T" to include all predecessor companies.

[381] Between 1894 and 1904, "over six thousand independent telephone companies went into business in the United States, and the number of telephones boomed from 285,000 to 3,317,000." *See* AT&T Brief History. By 1900, independent telephone companies controlled "38 percent of the phones installed in the United States." GERALD W. BROCK, THE TELECOMMUNICATIONS INDUSTRY, THE DYNAMICS OF MARKET STRUCTURE 148 (1981) (THE TELECOMMUNICATIONS INDUSTRY). And, by 1902, 451 out of 1002 cities with telephone service had two or more competing providers. *See* MICHAEL K. KELLOGG ET AL, FEDERAL TELECOMMUNICATIONS LAW 11 (1992) (FEDERAL TELECOMMUNICATIONS LAW).

[382] THE TELECOMMUNICATIONS INDUSTRY at 116.

[383] FEDERAL TELECOMMUNICATIONS LAW at 11; *see also* Adam D. Thierer, *Unnatural Monopoly: Critical Moments In The Development Of The Bell System Monopoly*, 14 CATO J. 2 (1994), *available at* http://www.cato.org/pubs/journal/cjv14n2-6.html (*Unnatural Monopoly*). Although independent companies competed with AT&T for local service, AT&T had the only long-distance network operating at

ing to interconnect with any independent telephone company to exchange long-distance or local traffic.[384] Without interconnection, independent telephone companies could not offer a viable service unless such entities duplicated the AT&T system, which was not economically feasible. As a result, independent telephone companies began to go out of business or were acquired by AT&T.[385]

156. AT&T's predatory strategy led the Department of Justice to file an antitrust suit against AT&T in 1913. The government alleged that AT&T's interconnection and acquisition policies violated Section 2 of the Sherman Act.[386] The case was eventually dropped after AT&T committed to abide by certain principles in what became known as the Kingsbury Commitment of 1913. Under the Kingsbury Commitment, AT&T agreed to: (i) allow

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the time and possessed important long-distance technology patents. *See* THE TELECOMMUNICATIONS INDUSTRY at 148. According to Brock, there is some evidence that the independent companies had planned on starting a separate long-distance network until AT&T refused interconnection. GERALD W. BROCK, THE SECOND INFORMATION REVOLUTION 30-32 (2003) (SECOND INFORMATION REVOLUTION).

[384] FEDERAL TELECOMMUNICATIONS LAW at 11-12; THE TELECOMMUNICATIONS INDUSTRY at 148; David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894-1912*, 102 J. POL. ECON. 103, 103-26 (1994).

[385] FEDERAL TELECOMMUNICATIONS LAW at 11. In 1912 alone, AT&T purchased 136,000 telephone companies and sold 43,000. *See* THE TELECOMMUNICATIONS INDUSTRY at 156.

[386] Original Petition, *United States v. AT&T*, No. 6082 (D. Or. 1913); *United States v. AT&T*, No. 6082, 1 DECREES AND JUDGMENT IN CIVIL ACTION CASES 483 (D. Or. 1914); *see also* PETER TEMIN, THE FALL OF THE BELL SYSTEM: A STUDY IN PRICES AND POLITICS 9-10 (1987); ROBERT W. GARNET, THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM'S HORIZONTAL STRUCTURE, 1876-1909 152-53 (1985).

independent telephone companies to interconnect with AT&T's long-distance network; and (ii) not acquire any additional independent telephone companies absent regulatory approval.[387] In exchange, the government sanctioned AT&T's monopoly control over markets where it already offered service.

157. In essence, the Kingsbury Commitment and subsequent regulation assumed that both the local and long-distance telephone businesses were natural monopolies.[388] Policymakers embraced the view that, because of economies of scale, a natural monopoly could provide service more efficiently than would occur in a competitive market.[389] Rates for these natural monopolies were sub-

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[387] The Kingsbury Commitment was a "unilateral letter rather than an actual consent decree." *See* THE TELECOMMUNICATIONS INDUSTRY at 155. The Kingsbury Commitment was republished in AT&T's 1913 Annual Report at 24-26, *available at* http://www.porticus.org/bell/pdf/1913ATTar_Complete.pdf. AT&T also agreed to sell off its Western Union stock, a large independent telephone company that AT&T had recently acquired. *See id.* at 24. *See* FEDERAL TELECOMMUNICATIONS LAW at 11-12; *see also Unnatural Monopoly*.

[388] *See, e.g.*, *Unnatural Monopoly* (noting that a Senate Commerce Committee hearing in 1921 stating that "telephoning is a natural monopoly" and a House of Representative committee report stated that "[t]here is nothing to be gained by local competition in the telephone business.") (quoting G. H. Loeb, *The Communications Act Policy Toward Competition: A Failure to Communicate*, 1 DUKE LAW J. 14 (1978)); *see also id.* (explaining that many state regulatory agencies began refusing requests by telephone companies to construct new lines in areas already served by another carrier and continued to encourage monopoly swapping and consolidation in the name of "efficient service") (citing Warren G. Lavey, *The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915*, 39 FED. COMM. L.J. 171, 184-85 (1987)); FEDERAL TELECOMMUNICATIONS LAW at 17.

[389] A natural monopoly arises "when a single firm can efficiently serve the entire market because average costs are lower with one

ject to rate-of-return regulation.[390] In setting regulated rates, a primary policy objective of regulators was to promote universal service to all consumers through affordable local telephone rates for residential customers. To accomplish this objective, however, regulators created a patchwork of what has become known as implicit subsidies. Thus, for example, regulators permitted higher rates to business customers so that residential rates could be lower, and they frequently required similar rates to urban and rural customers, even though the cost of serving rural customers was higher.[391] Similarly, AT&T was permitted to charge artificially high long-distance toll rates, and its interstate toll revenues were placed into an interstate "settlements" pool.[392] AT&T

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firm than with two firms." R. PRESTON MCAFEE, INTRODUCTION TO ECONOMIC ANALYSIS 6-241 (2006), *available at* http://www.mcafee.cc/Introecon/IEA.pdf; *see also* DANIEL F. SPULBER, REGULATION AND MARKETS 3-4 (1989) ("Natural monopoly generally refers to a property of productive technology, often in conjunction with market demand, such that a single firm is able to serve the market at less cost than two or more firms. Natural monopoly is due to economies of scale or economies of multiple-output production.").

[390] For discussions of rate of return regulation, see, *e.g.*, JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES 197-376 (1988); CHARLES F. PHILLIPS, JR., THE ECONOMICS OF REGULATION: THEORY AND PRACTICE IN THE TRANSPORTATION AND PUBLIC UTILITY INDUSTRIES 260-302 (1969) (PHILLIPS, THE ECONOMICS OF REGULATION); 1 ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 20-58 (1970) (THE ECONOMICS OF REGULATION).

[391] *See, e.g.*, JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS: AMERICAN TELECOMMUNICATIONS POLICY IN THE INTERNET AGE 10-15 (2007) (DIGITAL CROSSROADS).

[392] *See Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Information, Jurisdictional Separations and Rate Structures*, Docket No. 20003, First Report, 61 FCC 2d 766, 796-97, paras. 81-82 (1976).

then shared a portion of these interstate revenues with independent telephone companies and AT&T's affiliated Bell Operating Companies (BOCs).[303] These high long-distance rates enabled regulators to set lower local rates for the BOCs and independent local telephone companies.

158. The use of microwave technology by Microwave Communications, Inc. (MCI), to offer a competitive alternative to AT&T's switched long-distance service beginning in the 1970s cast into doubt the assumption that long-distance telecommunications was a natural monopoly.[304] MCI focused initially on private line service, where AT&T's rates were above cost. MCI's service offerings grew after a series of Commission and court decisions rejected AT&T's objections to MCI's entry.[305] Despite

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[303] Under the settlements process, the local exchange companies were allowed to recover the portion of their costs allocated to the interstate jurisdiction from the interstate toll revenues. The process for affiliated companies was a process of intracorporate accounting known as "division of revenues," while the process for unaffiliated companies represented real payments from AT&T to the independent companies. *See* THE SECOND INFORMATION REVOLUTION at 188. According to Brock, the revenue sharing settlements process was a major source of support for small rural companies, which often could recover a large share of their costs from the interstate toll revenue pool (in some cases as much as 85% of their non-traffic sensitive costs). *See id.*

[304] *See* DIGITAL CROSSROADS at 60-64.

[305] AT&T argued that MCI would cherry pick the most profitable customers (those paying above-cost rates) and force AT&T to increase local rates thereby undermining the goal of universal service. AT&T opposed the entry of MCI before the Commission and the courts. *See* FEDERAL TELECOMMUNICATIONS LAW at 602-14; *Bell System Tariff Offerings of Local Distribution Facilities for Use by Other Common Carriers*, Docket No. 19896, Decision, 46 FCC 2d 413 (1974), *aff'd Bell Tel. Co. of Pa. v. FCC*, 503 F.2d 1250 (3d Cir. 1974); *see also* DIGITAL CROSSROADS at 60-64 (noting that AT&T fought

these victories, MCI was not entitled to equal access to local exchange service,[396] and MCI and other IXCs were dependent on the BOCs and independent local telephone companies to complete long-distance calls to the end users.[397]

159. For a number of reasons, including AT&T's resistance to the introduction of competition in the long-distance market, the Department of Justice in 1974 filed an antitrust suit alleging that AT&T had engaged in unlawful monopolization in the local, long-distance, and equipment manufacturing markets.[398] After eight years of litigation, AT&T and the Department of Justice entered into a consent decree, which federal District Court Judge Greene approved in 1982.[399] Under the Modifica-

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"tooth and nail" to deprive MCI of effective access and even unplugged certain MCI lines from AT&T's network).

[396] Equal access requires that all long-distance carriers be accessible by dialing a 1 and not a string of long-distance codes before dialing the called party's telephone number. *See, e.g.*, HARRY NEWTON, NEWTON'S TELECOM DICTIONARY 326 (16th ed. 2000).

[397] During much of the 1970s, AT&T and MCI debated before the Commission and courts about the charges that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. In December 1978, under the Commission's supervision, AT&T, MCI, and other IXCs entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), which set the rates that AT&T's affiliated BOCs would charge IXCs for originating and terminating access to local exchange networks. *See Exchange Network Facilities for Interstate Access (ENFIA)*, CC Docket No. 78-371, Memorandum Opinion and Order, 71 FCC 2d 440 (1979) (subsequent history omitted).

[398] *See United States v. AT&T*, 524 F. Supp. 1336, 1346 (D.D.C. 1981).

[399] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The 1982 consent decree, as entered by the court, was called the Modification

tion of Final Judgment (MFJ), AT&T agreed to divest its affiliated BOCs from AT&T long distance, and the BOCs were required to provide equal access and dialing parity.[400] In addition, the MFJ barred the BOCs from entering the long-distance, information services, equipment manufacturing, or other competitive markets to prevent predatory cross subsidization by their regulated monopoly local telephone service.[401] Although the MFJ applied only to the BOCs, the Commission subsequently extended interconnection and nondiscriminatory equal access obligations to all incumbent LECs.[402] As a result of the MFJ, MCI, and other competitors were able to compete directly with AT&T to provide long-distance or interstate service, and all IXCs paid interstate access charges to the BOCs and other incumbent LECs to originate and terminate service to end users.

160. While the AT&T antitrust suit was pending, the Commission began to take the first steps toward reform-

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of Final Judgment because it modified a 1956 Final Judgment against AT&T stemming from a 1949 antitrust lawsuit. *See* THE TELECOMMUNICATIONS INDUSTRY at 116-20.

[400] The Act defines "dialing parity" to mean that a "person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier)." 47 U.S.C. § 153(15).

[401] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982).

[402] *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983) (*1983 Access Charge Order*), *modified on recon.*, 97 FCC 2d 682 (1983), *modified on further recon.*, 97 FCC 2d 834 (1983), *aff'd in part and remanded in part, Nat'l Ass'n of Regulatory Util. Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984).

ing intercarrier compensation. In 1978, the Commission commenced a review of intercarrier compensation for originating and terminating access.[403] In 1983, following the MFJ, the Commission eliminated the "existing potpourri of [compensation] mechanisms,"[404] and replaced it "with a single uniform mechanism . . . through which local carriers [could] recover the cost of providing access services needed to complete interstate and foreign telecommunications."[405] The access charge rules adopted by the Commission provided for the recovery of incumbent LECs' costs assigned to the interstate jurisdiction and detailed "the precise manner in which [incumbent LECs] may assess charges on IXCs and end users."[406] In designing the interstate access charge rules, the Commission sought to balance a number of competing objectives.[407] For one, the Commission recognized that "[a]rti-

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[403] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Notice of Inquiry and Proposed Rulemaking, 73 FCC 2d 222 (1979); Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980); Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980); and Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, 90 FCC 2d 135 (1982).

[404] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 683, para. 2 (1983) (*First Reconsideration of 1983 Access Charge Order*).

[405] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682.

[406] *See Access Charge Reform Order*, 12 FCC Rcd at 15991-92, para. 22.

[407] *See, e.g., First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 683, para. 3 (identifying the four primary objectives of: (1) elimination of unreasonable discrimination and undue preferences among rates for interstate services; (2) efficient use of the local net-

ficial pricing structures, while perhaps appropriate for use in achieving social objectives under the right conditions, cannot withstand the pressures of a competitive marketplace."[408] Consequently, the Commission sought to follow more closely the principle that costs should be recovered in the way they are incurred, consistent with principles of cost-causation.[409] Under this rate structure principle, the cost of facilities that do not vary based on the amount of traffic carried over those facilities (i.e., non-traffic-sensitive costs) should be recovered through fixed, flat-rated charges, while only costs that vary with usage of facilities (i.e., traffic-sensitive costs) should be recovered through corresponding per-minute rates.[410]

161. Despite these rate structure principles, the Commission concluded that a sudden introduction of large flat-rated charges on end-users could have "adverse effects" on subscribership. It therefore adopted a "plan [that] provides for the gradual introduction of these end-user charges."[411] Thus, the Commission limited the

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work; (3) prevention of uneconomic bypass; and (4) preservation of universal service).

[408] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 686, para. 7.

[409] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 688-89, para. 10; *see also Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24 ("The Commission has recognized in prior rulemaking proceedings that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation.").

[410] *Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 23.

[411] *1983 Access Charge Order*, 93 FCC 2d at 253, para. 35; *see also id.* at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be

amount of the interstate loop costs assessed to residential and business customers as a flat-rated monthly charge, and it recovered the remaining interstate loop costs through a per-minute charge imposed on IXCs.[412] Moreover, the Commission continued to apply traditional rate-of-return regulation based on carriers' embedded, fully distributed costs, including common costs and overhead.[413]

162. In 1991, the Commission took another step toward intercarrier compensation reform by replacing rate-of-return regulation with an incentive-based system of regulation for the BOCs and GTE.[414] This new regula-

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consistent with the goals of the Communications Act."). As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[412] This per-minute charge was called the carrier common line charge. *See Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24. Additional charges were imposed on IXCs to recover the interstate portion of the costs of other parts of a local exchange carrier's network, such as local switches and transport. *See First Reconsideration of 1988 Access Charge Order*, 97 FCC 2d at 735-40, paras. 129-34, 137-43.

[413] *See* 47 C.F.R. §§ 69.301-.502; *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6787, para. 1 (1990) (*LEC Price Cap Order*). The rate-of-return regulations are set forth in Part 69 of our rules. *See generally* 47 C.F.R. §§ 69.1-701.

[414] Price cap regulation was mandatory for the BOCs and GTE and optional for other incumbent local exchange carriers. *See LEC Price Cap Order*, 5 FCC Rcd at 6818-20, paras. 257-79; *see also Access Charge Reform; Price Cap Performance Review for Local Exchanges Carriers; Interexchange Carrier Purchases of Switch Access Services Offered by Competitive Local Exchange Carriers; Petition of U.S. West Comme'ns, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket

tory regime, known as price cap regulation, was designed to replicate some of the efficiency incentives found in competitive markets. In particular, price caps were designed to encourage companies to: (1) improve their efficiency by creating incentives to reduce costs; (2) invest efficiently in new plant and facilities; and (3) develop and deploy innovative service offerings.[415] Although many smaller and rural incumbent LECs remain subject to the Part 69 rate-of-return rules, most of the larger incumbent LECs are now subject to price cap regulation.[416]

Nos. 96-262, 94-1, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14224 n.1 (1999) (*Pricing Flexibility Order*).

[415] *LEC Price Cap Order*, 5 FCC Rcd at 6789-91, paras. 21-37; *Special Access Rates for Price Cap Carriers*, WC Docket No. 05-25, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, 1998-99, para. 11 (2005); *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, CC Docket Nos. 96-149, 98-141, 96-149, 01-337, Report and Order, Memorandum Opinion and Order, 19 FCC Rcd 5102, 5115, para. 22 (2004); *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd 14976, 14979, para. 4 (2003); *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10873, para. 9 (2002). *See also Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order, 23 FCC Rcd 5294 (2008); *Petition of Puerto Rico Telephone Company, Inc, for Election of Price Cap Regulation and Limited Waiver of Pricing and Universal Service Rules; Consolidated Communications Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief; Frontier Petition for Limited Waiver Relief upon Conversion of Global Valley Networks, Inc., to Price Cap Regulation*, WC Docket Nos. 07-291, 07-292, 08-18, Order, 23 FCC Rcd 7353 (2008).

[416] *See generally* 47 C.F.R. §§ 61.1-.193, 69.1-.701.

163. The Commission's reforms during the 1980s and early 1990s yielded many public interest benefits. For example, economists have estimated that above-cost access charges reduced U.S. economic welfare by an estimated $10-17 billion annually during the late 1980s, but that the annual welfare loss declined substantially to between $2.5 billion and $7 billion following the Commission's access charge reforms in the 1980s and early 1990s.[417] Despite these reforms, however, per-minute access rates remained high.[418] These high switched access rates created an opportunity for competitive access providers (CAPs) to begin offering facilities-based competition. CAPs could offer carriers a competitive alternative to the BOCs, often with lower rates and higher quality.[419] The entry of CAPs and the potential entry of cable companies into local residential telephone markets created pressure toward opening the local telephone markets to

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[417] *See* Letter from Jerry Ellig, Senior Research Fellow, Mercatus Center, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 08-183, 07-135, 05-337, 99-68 at 2 (filed Sept. 22, 2008) (Mercatus Center Sept. 22, 2008 *Ex Parte* Letter) (citing ROBERT W. CRANDALL, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA 141 (1991) and ROBERT W. CRANDALL & LEONARD WAVERMAN, WHO PAYS FOR UNIVERSAL SERVICE? 120 (2000)).

[418] Among the reasons that switched access rates remained high were that they were based on fully distributed costs and included a large allocation of common and overhead network costs. *See supra* note 414.

[419] *See, e.g., Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154, 5158, para. 8 (1994) (recognizing that local competition should lead to more efficient operations, the deployment of "new technologies facilitating innovative service offerings, increase the choices available to access customers, and reduce the prices of services subject to competition").

competition, which ultimately resulted in the passage of the 1996 Act.

2. Intercarrier Compensation Regulation Since the 1996 Act

164. Recognizing these fundamental market changes, Congress's goals in passing the 1996 Act were to: (1) open local exchange and exchange access markets to competition; (2) promote increased competition in telecommunications markets that were already open to competition; and (3) reform the existing universal service system to be consistent with competitive markets.[420] With respect to the last goal, Congress recognized that implicit subsidies, which were implemented when the industry was considered a natural monopoly, were neither consistent with, nor sustainable in, a competitive market, and that they should be replaced with explicit support where necessary.[421] It also recognized, however, that conversion of the existing web of implicit subsidies to a system of explicit support would be a difficult task that could not be accomplished immediately.[422] Accordingly, when Congress established the statutory scheme to open local

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[420] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15505, para. 3 (1996) (subsequent history omitted) (*Local Competition First Report and Order*).

[421] Specifically, Congress directed that universal service support "should be explicit and sufficient to achieve the purposes" of section 254. 47 U.S.C. § 254(e); *see also* S. REP. No. 104-230, at 131 (1996) (Conf. Rep) (stating that, "[t]o the extent possible, . . . any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today").

[422] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

markets to competition,[423] it included a transitional mechanism in section 251(g) providing for the continued enforcement of certain pre-Act obligations.[424] Notably, section 251(g) provides for the continued enforcement of exchange access and interconnection obligations only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after the date of such enactment," suggesting that such obligations would be reevaluated based on the requirements imposed by the 1996 Act.[425]

165. Congress also recognized the need to impose new obligations on carriers to open local telephone markets to competition, and directed the Commission to adopt implementing rules. Specifically, section 251(b) imposed certain obligations on all LECs, while section 251(c) imposed additional obligations on incumbent LECs, including the obligation to provide access to network elements on an unbundled basis.[426] Of relevance here, section 251(b)(5) of the 1996 Act imposed on all LECs a "duty to establish reciprocal compensation ar-

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[423] *See* 47 U.S.C. §§ 251-52; *Local Competition First Report and Order*, 11 FCC Rcd at 15505, para. 3.

[424] *See* 47 U.S.C. § 251(g); *WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002) (*WorldCom*) (subsequent history omitted) (holding that section 251(g) appears to provide for the continued enforcement "of certain pre-Act regulatory 'interconnection restrictions and obligations'"); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) (finding that section 251(g) preserves certain rate regimes already in place and "leaves the door open for the promulgation of new rates at some future date").

[425] 47 U.S.C. § 251(g).

[426] *See* 47 U.S.C. §§ 251(b)-(c). Certain rural carriers were exempt from section 251(c) until such time as a requesting carrier met the statutory test for removing the so-called "rural exemption." *See* 47 U.S.C. § 251(f)(1).

rangements for the transport and termination of telecommunications."[427]

166. In requiring LECs to enter into reciprocal compensation agreements with requesting carriers, Congress introduced another mechanism through which carriers compensate each other for the exchange of traffic besides the access charge regime preserved under section 251(g). Although Congress expressed a preference for negotiated interconnection agreements to implement the requirements of section 251, section 252 provided procedures for the resolution of interconnection disputes involving incumbent LECs, including standards governing arbitration of such disputes by state regulatory commissions.[428] For such state arbitrations, section 252(d) also established general pricing guidelines for incumbent LECs, including guidelines for setting the price of unbundled network elements (UNEs)[429] and reciprocal compensation rates.[430]

167. In the *Local Competition First Report and Order*, the Commission adopted pricing rules for states to use in setting the price of interconnection and UNEs when arbitrating interconnection disputes.[431] In parti-

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[427] 47 U.S.C. § 251(b)(5).

[428] 47 U.S.C. § 252.

[429] 47 U.S.C. § 252(d)(1).

[430] See 47 U.S.C. § 252(d)(2).

[431] *See Local Competition First Report and Order*, 11 FCC Rcd at 15812-929, paras. 618-862 (implementing the pricing principles contained in sections 251(c)(2) and (c)(3) and section 252(d)(1) of the 1996 Act); *see also* 47 U.S.C. §§ 251(c)(2)-(3), 252(d)(1). Among other things, the 1996 Act required incumbent LECs to make portions of their networks (the physical facilities and features, functions, and capabilities associated with those facilities) available to requesting competitive carriers on an unbundled basis. *See Local Competition*

cular, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, which it called "Total Element Long-Run Incremental Cost" or "TELRIC."[432] The Commission found that TELRIC prices should include a reasonable allocation of forward-looking common costs, including overheads.[433] Although the Commission recognized that peak-load pricing was the most efficient way to recover the cost of traffic-sensitive facilities, it did not require states to adopt peak-load pricing because of the administrative difficulties associated with such an approach.[434] In

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First Report and Order, 11 FCC Rcd at 15624, 15631, paras. 241, 258.

[432] *See Local Competition First Report and Order*, 11 FCC Rcd at 15844-56, paras. 672-703.

[433] *See Local Competition First Report and Order*, 11 FCC Rcd at 15851-54, paras. 694-98; 47 C.F.R. §§ 51.503, 51.505. The term "common costs" refers to "costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies." *Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676. In its rules, the Commission defines forward-looking common costs as "economic costs efficiently incurred in providing a group of elements or services . . . that cannot be attributed directly to individual elements or services." 47 C.F.R. § 51.505(c)(1). The term "overhead costs" refers to common costs incurred by the firm's operations as a whole, such as the salaries of executives. *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 694.

[434] The Commission recognized that, "[b]ecause the cost of capacity is determined by the volume of traffic that the facilities are able to handle during peak load periods, we believe, as a matter of economic theory, that if usage-sensitive rates are used, then somewhat higher rates should apply to peak period traffic, with lower rates for non-peak usage." *Local Competition First Report and Order*, 11 FCC Rcd at 15878, para. 755. The Commission recognized that higher costs are incurred to carry additional traffic at peak volumes, because additional capacity is required to carry that traffic. *Id.* at

interpreting the statutory pricing rules for reciprocal compensation contained in section 252(d)(2)(A) of the 1996 Act,[42] the Commission found that costs for transport and termination should "be recovered in a cost-causative manner and that usage based charges should be limited to situations where costs are usage sensitive."[43] In particular, the Commission found that the

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15878, para. 755. In contrast, "off peak traffic imposes relatively little additional cost because it does not require any incremental capacity to be added to base plant." *Id.* at 15878, para. 755. The Commission found that there would be administrative difficulties with establishing peak-load prices, however, and did not require or forbid states from adopting that approach. *Id.* at 15878-79, paras. 756-57.

[42] *See generally Local Competition First Report and Order*, 11 FCC Rcd at 16008-58, paras. 1027-118 (implementing the reciprocal compensation obligations contained in section 251(b)(5) of the 1996 Act). The reciprocal compensation rules currently require the calling party's LEC to compensate the called party's LEC for the additional costs associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office, and for the additional costs of terminating the call to the called party. Section 51.701(c) of the Commission's rules defines transport as "the transmission and any necessary tandem switching of telecommunications traffic subject to section 251(b)(5) of the Act from the interconnection point between the two carriers to the terminating carrier's end office switch that directly serves the called party, or equivalent facility provided by a carrier other than an incumbent LEC." 47 C.F.R. § 51.701(c). Section 51.701(d) of the Commission's rules defines termination as "the switching of telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises." 47 C.F.R. § 51.701(d). In the *Local Competition First Report and Order*, the Commission also concluded that "the new transport and termination rules should be applied to LECs and CMRS providers." 11 FCC Rcd at 16016-17, para. 1043.

[43] *Local Competition First Report and Order*, 11 FCC Rcd at 16028, para. 1063. This determination led to per-minute pricing for transport and termination, except in the case of dedicated facilities, which may be flat rated. *Id.* at 16028, para. 1063. Specifically, the

"additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching" and that non traffic-sensitive costs, such as the costs of local loops and line ports, should not be considered "additional costs."[437] The Commission further found that the "additional costs" standard of section 252(d)(2) permits the use of the same TELRIC standard that it established for interconnection and unbundled elements.[438] The pricing rules governing reciprocal compensation that the Commission adopted in the *Local Competition First Report and Order* remain in effect today.[439]

Commission required that all interconnecting parties be offered the option of purchasing dedicated facilities on a flat-rated basis. *Id.* at 16028, para. 1063.

[437] *Local Competition First Report and Order*, 11 FCC Rcd at 16024-25, para. 1057. Although the Commission concluded that "non-traffic sensitive costs should not be considered 'additional costs,'" the only non-traffic sensitive costs specifically identified and required to be removed were the costs of local loops and line ports. *Id.* at 16025, para. 1057.

[438] *Local Competition First Report and Order*, 11 FCC Rcd at 16023-25, paras. 1054-58. As with its pricing rules for UNEs, the Commission determined that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of forward-looking common costs. *Id.* at 16025, para. 1058. Similarly, the Commission again noted that the costs of transporting and terminating traffic during peak and off-peak hours may not be the same. *Id.* at 16028-29, para. 1064. In light of administrability concerns, the Commission once again neither required nor forbid states from adopting rates that reflected peak and off-peak costs, but expressed hope that some states or negotiating parties would consider peak-load pricing. *Id.* at 16028-29, para. 1064.

[439] A number of parties appealed the Commission's *Local Competition First Report and Order*, including the rules it adopted governing the setting of rates for unbundled network elements and reciprocal compensation. In *AT&T v. Iowa Utilities Board*, the Supreme

168. Following passage of the 1996 Act, the Commission also began reforming both interstate access charges and federal universal service support mechanisms by moving the implicit subsidies contained in interstate access charges into explicit universal service support, consistent with the 1996 Act's directives. In particular, in the 1997 *Access Charge Reform Order*, the Commission modified the price cap rules for larger incumbent LECs by aligning the price cap LECs' rate structure more closely with the manner in which costs are incurred.[440] Recognizing Congress's direction that universal service support should be "explicit," the Commission adopted rules to "reduce usage-sensitive interstate access charges by phasing out local loop and other non-traffic sensitive costs from those charges and directing incumbent LECs to recover those NTS [non-traffic sensitive] costs through more economically efficient, flat-rated charges."[441]

Court upheld the Commission's jurisdiction to "design a pricing methodology" to govern state rate setting under section 252 of the Act. *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999) (*AT&T v. Iowa Utils. Bd.*). Subsequently, in *Verizon Commc'ns, Inc. v. FCC*, the Supreme Court affirmed the Commission's choice of TELRIC as a permissible methodology for states to use in ratemaking proceedings. *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 497-529 (2002) (*Verizon v. FCC*). The court held that the Commission's decision to adopt a forward-looking cost methodology was a reasonable interpretation of the statute and that the Commission did not err in rejecting alternative methodologies advocated by the incumbent LECs. *Verizon v. FCC*, 535 U.S. at 507-08. The Court also rejected arguments that various aspects of the TELRIC methodology were unlawful. *Verizon v. FCC*, 535 U.S. at 523.

[440] *See Access Charge Reform Order*, 12 FCC Rcd at 16004-07, paras. 54-66 (summarizing the rate structure changes).

[441] *Access Charge Reform Order*, 12 FCC Rcd at 15986, para. 6.

169. The Commission acknowledged, however, that the measures it adopted in the *Access Charge Reform Order* would not "remove all implicit support from all access charges immediately."[442] Rejecting suggestions that all implicit subsidies be eliminated from access charges immediately, the Commission noted that it did not have the tools to identify the existing subsidies precisely, and it expressed concern that eliminating all implicit subsidies at once might have an "inequitable impact on the incumbent LECs."[443] Moreover, while stating its desire to rely on competition to drive access charges toward cost,[444] the Commission recognized that "some services may prove resistant to competition," and it reserved the right to "adjust rates in the future to bring them into line with forward-looking costs."[445]

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[442] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[443] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9; *see also id.* at 16002-03, paras. 45-47.

[444] Explaining its reliance on a "market-based" approach to access reform, it stated its belief that emerging competition in the local exchange markets would provide a more accurate means of identifying implicit subsidies and moving access rates to economically sustainable levels. *Access Charge Reform Order*, 12 FCC Rcd at 16001-02, para. 44.

[445] *Access Charge Reform Order*, 12 FCC Rcd at 16003, para. 48. The Commission also applied its market-based approach to the terminating access rates charged by competitive LECs and declined to adopt any regulations governing competitive LEC access charges. *Id.* at 16141, para. 363. It reasoned that "the possibility of competitive responses by IXCs will have a constraining effect on non-incumbent LEC pricing." *Id.* at 16141, para. 362. This reliance on a market-based approach proved misplaced. In subsequent years, competitive LECs, instead of reducing access charges, frequently raised them above the regulated rates of incumbent LECs. As a result, the Commission was forced to regulate competitive LEC access charges. *See* 47 C.F.R. § 61.26; *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers,*

170. To limit possible rate shock to retail customers, the Commission also limited the amount of allocated interstate cost of a local loop that could be assessed directly on residential and business customers as a flat-rated monthly charge.[446] Although the *Access Charge Reform Order* started the process toward establishing explicit subsidies, the Commission concluded that "a process that eliminates implicit subsidies from access charges over time [was] warranted."[447]

171. In the 2000 *CALLS Order*,[448] the Commission continued its effort to remove implicit subsidies and replace them with explicit universal service support for price cap LECs by, among other things, reducing per-minute intercarrier charges, raising the SLC cap, phasing out the Presubscribed Interexchange Carrier Charge

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CC Docket No. 96-262, Seventh Report and Order, 16 FCC Rcd 9923, 9924, paras. 1-3 (2001) (*CLEC Access Charge Order*) (establishing benchmark rates for competitive LEC access charges), *recon.*, *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Petition of Z-Tel Commc'ns Inc. For Temporary Waiver of Commission Rule 61.26(d) to Facilitate Deployment of Competitive Service in Certain Metropolitan Statistical Areas*, CC Docket No. 96-262, CCB/CPD File No. 01-19, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108 (2004) (*CLEC Access Charge Recon. Order*).

[446] *See, e.g.*, *Access Charge Reform Order*, 12 FCC Rcd at 16010-11, para 73. To reduce per-minute carrier common line (CCL) charges, the Commission created the presubscribed interexchange carrier charge (PICC), a flat-rated, monthly charge imposed on IXCs on a per-line basis. *Id.* at 15998-16000, paras. 37-40. The Commission also shifted the cost of line ports from per-minute local switching charges to the common line category and established a mechanism to phase out the per-minute Transport Interconnection Charge (TIC). *Id.* at 16035-40, 16073-86, paras. 125-34, 210-43.

[447] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[448] *See CALLS Order*, 15 FCC Rcd 12962.

(PICC),[449] and permitting price-cap LECs to deaverage the SLC once the affected carrier charges were eliminated.[450] The Commission also created a new universal service fund to compensate price-cap incumbent LECs, in part, for lost interstate access revenues.[451]

172. In the *MAG Order*, the Commission extended similar reforms to incumbent LECs subject to rate-of-return regulation.[452] As with the *CALLS Order*, these re-

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[449] *See supra* note 455 (discussing the PICC).

[450] *See generally CALLS Order*, 15 FCC Rcd at 13025-28, paras. 151-59 (reducing interstate switched access rates); *id.* at 12991-13007, paras. 76-112 (raising SLC caps and eliminating PICCs); *id.* at 13007-14, paras. 113-28 (deaveraging SLCs).

[451] *See CALLS Order*, 15 FCC Rcd at 13046-49, paras. 201-05 (establishing a "$650 million interstate access universal service support mechanism").

[452] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613 (2001) (*MAG Order*), *recon. in part*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon.*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003); *see also Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers*

forms were designed to rationalize the interstate access rate structure by aligning it more closely with the manner in which costs are incurred.[453] Among other things, the *MAG Order* increased the SLC caps for rate-of-return carriers and phased out the per-minute CCL charge from the common line rate structure.[454] The Commission also created a universal service support mechanism to replace implicit support with explicit support, in order to foster competition and more efficient pricing.[455] Many, but not all, states have also addressed intercarrier compensation regulation. In addition to setting rates for reciprocal compensation, many states have revised their rules governing intrastate access charges. Although some states have chosen to mirror interstate

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and Interexchange Carriers; *Federal-State Joint Board on Universal Service*, CC Docket Nos. 00-256, 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004).

[453] *MAG Order*, 16 FCC Rcd at 19617, para. 3.

[454] *MAG Order*, 16 FCC Rcd at 19621, para. 15.

[455] *MAG Order*, 16 FCC Rcd at 19617, para. 3. A new universal service support mechanism, Interstate Common Line Support (ICLS), was implemented to replace the CCL charge beginning July 1, 2002. *Id.* at 19621, para. 15. This mechanism recovers any shortfall between the allowed common line revenue requirement of rate-of-return carriers and their SLC and other end-user revenues, thereby ensuring that changes in the rate structure did not affect the overall recovery of interstate access costs by rate-of-return carriers serving high-cost areas. *Id.* at 19642, 19667-73, paras. 61, 128-41. To reform the local switching and transport rate structure of rate-of-return carriers, the Commission shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the TIC to other access rate elements, thus reducing per-minute switched access charges. *Id.* at 19649-61, paras. 76-111.

access charges,[456] others continue to maintain intrastate access charges that far exceed interstate charges.[457]

3. Problems Associated With the Existing Intercarrier Compensation Regimes

173. The introduction of competition into local telephone markets revealed weaknesses in the existing intercarrier compensation regimes that remained notwithstanding the efforts of the Commission and certain states to reform interstate and intrastate access charges. As the Commission observed in 2001, "[i]nterconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation regulations . . . [that] treat different types of carriers and different types of services disparately, even though there may be no significant differences in the costs among car-

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[456] *See, e.g.*, *BA-WV's Intrastate Access Charges*, Case No. 00-0318-T-GI, Commission Order, 2001 WL 935643 (West Virginia PSC June 1, 2001) (ordering that "the traffic-sensitive intrastate access charges of Verizon-WV shall be modified to mirror the interstate rate structure and rate elements"); *Tariff Filing of BellSouth Telecommunications, Inc to Mirror Interstate Rates*, Case No. 98-065, Order (Kentucky PSC Mar. 31, 1999) (requiring BellSouth "to eliminate the state-specific Non-Traffic Sensitive Revenue Requirement . . . , thus moving its aggregate intrastate switched access rate to the FCC's 'CALLS' interstate rate"); *Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Order, 2007 WL 3023991 (Ohio PUC Oct. 17, 2007) ("[T]his Commission requires ILECs to mirror their interstate switched access rate on the intrastate side . . . .").

[457] *See, e.g.*, Letter from David C. Bartlett, Vice President of Federal Government Affairs, Embarq, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Exh. C (filed Aug. 1, 2008) (noting intrastate terminating switched access rates five to ten times higher than interstate rates in Missouri, Washington, Virginia, and several other States).

riers or services."[458] We have seen numerous examples of regulatory arbitrage in the marketplace both because of the different rates for similar functions under different intercarrier compensation regimes and because none of these regimes currently set rate levels in an economically efficient manner.[459]

174. One example of regulatory arbitrage involves traffic to dial-up ISPs. Following adoption of the *Local Competition First Report and Order*, state commissions set reciprocal compensation rates for the exchange of local traffic. These reciprocal compensation rates were sufficiently high that many competitive LECs found it profitable to target and serve ISP customers who were large recipients of local traffic, since dial-up Internet customers would call their ISP and then stay on the line for hours. This practice led to significant traffic imbalances, with competitive LECs seeking billions of dollars in reciprocal compensation payments from other LECs.[460] The Commission responded by adopting a separate interim intercarrier compensation regime for this traffic.

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[458] *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[459] The phrase "regulatory arbitrage" refers to profit-seeking behavior that can arise when a regulated firm is required to set difference prices for products or services with a similar cost structure. *See, e.g.*, PATRICK DEGRABA, BILL AND KEEP AT THE CENTRAL OFFICE AS THE EFFICIENT INTERCONNECTION REGIME 1, para. 2 n.3 (Federal Communications Commission, OPP Working Paper No. 33, 2000), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp33.pdf.

[460] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9183, para. 70 (2001) (subsequent history omitted) (*ISP Remand Order*).

175. On February 26, 1999, the Commission issued a Declaratory Ruling and Notice of Proposed Rulemaking in which it held that ISP-bound traffic is jurisdictionally interstate because end users access websites across state lines. Because the *Local Competition First Report and Order* concluded that the reciprocal compensation obligation in section 251(b)(5) applied to only local traffic, the Commission found in the *Declaratory Ruling* that ISP-bound traffic is not subject to section 251(b)(5).[461] On March 24, 2000, in the *Bell Atlantic* decision, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) vacated certain provisions of the *Declaratory Ruling*.[462] The court did not question the Commission's finding that ISP-bound traffic is interstate. Rather, the court held that the Commission had not adequately explained how its end-to-end jurisdictional analysis was relevant to determining whether a call to an ISP is subject to reciprocal compensation under section 251(b)(5).[463] In particular, the court noted that a LEC serving an ISP appears to perform the function of "termination" because the LEC delivers traffic from the calling party through its end office switch to the called party, the ISP.[464]

176. On April 27, 2001, the Commission released the *ISP Remand Order*, which concluded that section 251(g) excludes ISP-bound traffic from the scope of section

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[461] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Declaratory Ruling and Notice of Proposed Rulemaking, 14 FCC Rcd 3689, 3703-06, paras. 21-27 (1999) (*Declaratory Ruling*), *vacated and remanded, Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

[462] *Bell Atlantic*, 206 F.3d at 1.

[463] *See Bell Atlantic*, 206 F.3d at 5.

[464] *Bell Atlantic*, 206 F.3d at 6.

251(b)(5).[465] The Commission explained that section 251(g) maintains the pre-1996 Act compensation requirements for "exchange access, information access, and exchange services for such access," thereby excluding such traffic from the reciprocal compensation requirements that the 1996 Act imposed. The Commission concluded that ISP-bound traffic is "information access" and, therefore, is subject instead to the Commission's section 201 jurisdiction over interstate communications.[466] The Commission concluded that a bill-and-keep regime might eliminate incentives for arbitrage and force carriers to look to their own customers for cost recovery.[467] To avoid a flash cut to bill-and-keep, however, the Commission adopted an interim compensation regime pending completion of the *Intercarrier Compensation* proceeding.[468]

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[465] *See ISP Remand Order*, 16 FCC Rcd at 9171-72, para. 44.

[466] *See ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. Thus, the Commission affirmed its prior finding in the *Declaratory Ruling* that ISP-bound traffic is jurisdictionally interstate. *See id*; *see also Declaratory Ruling*, 14 FCC Rcd at 3701-03, paras. 18-20.

[467] *ISP Remand Order*, 16 FCC Rcd at 9184-85, paras. 74-75. The Commission discussed at length the market distortions and regulatory arbitrage opportunities created by the application of per-minute reciprocal compensation rates to ISP-bound traffic. In particular, the Commission found that requiring compensation for this type of traffic at existing reciprocal compensation rates undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers, thereby distorting the price signals sent to their ISP customers. *See id.* at 9181-86, paras. 67-76.

[468] *See ISP Remand Order*, 16 FCC Rcd at 9155-57, paras. 7-8. The interim regime adopted by the Commission consisted of: (1) a gradually declining cap on Intercarrier Compensation for ISP-Bound Traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use; (2) a growth cap on total ISP-bound minutes for

177. On May 3, 2002, the D.C. Circuit found that the Commission had not provided an adequate legal basis for the rules it adopted in the *ISP Remand Order*.[469] Once again, the court did not question the Commission's finding that ISP-bound traffic is jurisdictionally interstate. Rather, the court held that section 251(g) of the Act did not provide a basis for the Commission's decision. The court held that section 251(g) is simply a transitional device that preserved obligations that predated the 1996 Act until the Commission adopts superseding rules, and there was no pre-1996 Act obligation with respect to intercarrier compensation for ISP-bound traffic.[470] Although the court rejected the legal rationale for the interim compensation rules, the court remanded, but did not vacate, the *ISP Remand Order* to the Commission, and it observed that "there is plainly a non-trivial likelihood that the Commission has authority" to adopt the rules.[471] Accordingly, the interim rules adopted in the *ISP Remand Order* have remained in effect.

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which a LEC may receive this compensation; (3) a "new markets rule" requiring bill-and-keep for the exchange of this traffic if two carriers were not exchanging traffic pursuant to an interconnection agreement prior to the adoption of the interim regime; and (4) a "mirroring rule" that gave incumbent LECs the benefit of the rate cap only if they offered to exchange all traffic subject to section 251(b)(5) at the same rates. *Id.* at 9187-89, 9193-94, paras. 78, 80, 89. In a subsequent order, the Commission granted forbearance to all telecommunications carriers with respect to the growth caps and the new markets rule. *See Petition of Core Commc'ns Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, Order, 19 FCC Rcd 20179 (2004) (*Core Forbearance Order*). Thus, only the rate caps and mirroring rule remain in effect today.

[469] *See WorldCom*, 288 F.3d at 429.

[470] *See WorldCom*, 288 F.3d at 433.

[471] *See WorldCom*, 288 F.3d at 434.

178. On November 5, 2007, Core filed a petition for writ of mandamus with the D.C. Circuit seeking to compel the Commission to enter an order resolving the court's remand in the *WorldCom* decision.[472] On July 8, 2008, the court granted a writ of mandamus and directed the Commission to respond to the *WorldCom* remand in the form of a final, appealable order that "explains the legal authority for the Commission's interim intercarrier compensation rules that exclude ISP-bound traffic from the reciprocal compensation requirement . . . ."[473] The court directed the Commission to respond to the writ of mandamus by November 5, 2008.[474]

179. Another regulatory arbitrage opportunity arose as a result of the Commission's 1997 decision not to regulate the interstate access charges of competitive LECs. As a result, many competitive LECs filed tariffs with access charges that were well above the rates charged by incumbent LECs for similar services.[475] In response, the

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[472] Pet. for Writ of Mandamus, In re Core Communications Inc., No. 07-1446 (D.C. Cir. Nov. 5, 2007).

[473] *In re Core Commc'ns Inc.*, 531 F.3d 849, at 861-62 (D.C. Cir. 2008) (*Core Decision*).

[474] *See Core Decision*, 531 F.3d at 861-62. If the Commission fails to comply with the writ by the November 5th deadline, the interim rules will be vacated on November 6, 2008. *See id.* at 862.

[475] *See CLEC Access Charge Order*, 16 FCC Rcd at 9931, para. 22. For instance, the Commission found that certain competitive LECs charged $0.09 per minute and that the weighted average of competitive LEC access rates was above $0.04 per minute. *Id.* In contrast, the same underlying data showed a composite incumbent LEC rate of $0.0056 for that same traffic. *See* AT&T Additional Comments, CC Docket Nos. 96-262, 97-146, CCB/CPD File No. 98-63, App. A. (Jan. 11, 2001). The Commission found that competitive LECs could impose excessive charges due to two factors. First, the Commission observed that access charges are paid by the IXC rather than the end-user customer. Because the IXC has no ability to affect the call-

Commission adopted new rules that effectively capped the interstate access charges that competitive LECs could tariff.[476]

180. Two more recent examples of regulatory arbitrage involve billing problems and the "Access Stimulation" problem. Commenters describe problems billing for traffic when it arrives for termination with insufficient identifying information.[477] Because the existing intercarrier compensation mechanisms have vastly disparate rates that apply to different types of traffic, carriers have both the opportunity and incentive to disguise the nature, or conceal the source, of the traffic being sent in order to avoid or reduce payments to other carriers.[478] "Access Stimulation" refers to allegations that certain LECs may have entered into agreements with providers of services that generate large volumes of incoming calls to substantially increase the number of calls sent to the LEC.[479] It has been alleged that this significantly in-

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ing or called party's choice of service providers, it cannot avoid carriers with high access charges. *CLEC Access Charge Order*, 16 FCC Rcd at 9935, para. 31. Second, the Commission found that the rate averaging requirements in section 254(g) of the Act precluded IXCs from passing through particular competitive LECs' excessive access charges to the end user customers of those competitive LECs. *Id.* As a result, the Commission found the existing regulatory regime did not effectively create the incentives for the end users to select a lower-priced access provider. *Id.*

[476] *See* 47 C.F.R. § 61.26 (containing rules governing the tariffing of competitive LEC interstate switched exchange access services). As a general matter, the Commission's rules governing competitive LEC access charges limit these rates to those charged by the competing incumbent LEC. *Id.*

[477] *See infra* Part V.D.

[478] *See infra* para. 326.

[479] *See, e.g., Qwest Commc'ns Corp. v. Farmers and Merchs. Mut. Tel. Co.*, File No. EB-07-MD-001, Memorandum Opinion and Order,

creased "growth in terminating access traffic may be causing carriers' rates to become unjust or unreasonable" in violation of section 201 of the Act.[480] In the *Access Stimulation NPRM*, the Commission has sought information about the extent of this practice, its potential impact on the rates of price cap, rate-of-return, and competitive LECs, and how this practice should be addressed.[481]

B. Comprehensive Reform

1. Introduction

181. Evidence of increasing regulatory arbitrage, as well as increased competition and changes in technology, has led the Commission to consider comprehensive reform of intercarrier compensation. In 2001, the Commission adopted a Notice of Proposed Rulemaking to examine possible alternatives to existing intercarrier regimes with the intent of moving toward a more unified system.[482] The notice generated extensive comments that generally confirmed the need for comprehensive intercarrier compensation reform, including a number of

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22 FCC Rcd 17973, para. 1 (2007) (addressing Qwest's allegations that Farmers deliberately planned to "increase dramatically the amount of terminating access traffic delivered to its exchange, via agreements with conference calling companies").

[480] *See Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 17989, para. 1 (2007) (*Access Stimulation NPRM*).

[481] *Access Stimulation NPRM*, 22 FCC Rcd 17989

[482] *See Intercarrier Compensation NPRM*, 16 FCC Rcd 9610. The Commission acknowledged a number of problems with the existing regimes, including inefficient rates and different rates for the same types of calls. *Id.* at 9616-18, paras. 11-18. The Commission thus sought comment on alternative approaches to reforming intercarrier compensation, including moving to a bill-and-keep approach to intercarrier compensation. *Id.* at 9611-13, paras. 2-4.

competing proposals.[483] In 2005, the Commission adopted a Further Notice of Proposed Rulemaking seeking comment on the various industry proposals.[484] In 2006, an-

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[483] *See, e.g.*, Regulatory Reform Proposal of the Intercarrier Compensation Forum (ICF Proposal), *attached to* Letter from Gary M. Epstein and Richard R. Cameron, Counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, App. A (filed Oct. 5, 2004) (ICF Oct. 5, 2004 *Ex Parte* Letter); Comprehensive Plan For Intercarrier Compensation Reform of Expanded Portland Group (EPG Proposal), *attached to* Letter from Glenn H. Brown, EPG Facilitator, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); Intercarrier Compensation Reform Plan of Alliance for Rational Intercarrier Compensation (ARIC Plan), *attached to* Letter from Wendy Thompson Fast, President, Consolidated Companies, and Ken Pfister, Vice President—Strategic Policy, Great Plains Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, 96-98, WC Docket No. 04-36 (filed Oct. 25, 2004); Cost-Based Intercarrier Compensation Coalition (CBICC Proposal), *attached to* Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 2, 2004); Updated Ex Parte of Home Telephone Company, Inc. and PBT Telecom (Home/PBT Proposal), *attached to* Letter from Keith Oliver, Vice President, Finance, Home Telephone Company, and Ben Spearman, Vice President, Chief Regulatory Officer, PBT Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); NASUCA Intercarrier Compensation Proposal at 1 (NASUCA Proposal), *attached to* Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 14, 2004); Western Wireless Intercarrier Compensation Reform Plan at 9 (Western Wireless Proposal), *attached to* Letter from David L. Sieradzki, Counsel for Western Wireless Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 1, 2004).

[484] *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, 4687, para. 4 (2005) (*Intercarrier Compensation FNPRM*).

other industry coalition submitted an alternative comprehensive intercarrier compensation reform proposal, known as the Missoula Plan.[485] The Commission separately requested and received comments on the Missoula Plan proposal.[486] Finally, in 2008, the Commission stabilized the universal service fund by adopting an interim cap on payments to competitive ETCs, helping pave the way for comprehensive intercarrier compensation and universal service reform, and leading to a number of new reform proposals.[487]

182. As a result of the *Intercarrier Compensation NPRM*, the *Intercarrier Compensation FNPRM*, the

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[485] *See* Missoula Plan for Intercarrier Compensation Reform (Missoula Plan), *attached to* Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, NARUC Task Force, and Larry Landis, Commissioner and Vice-Chair, NARUC Task Force, to Hon. Kevin Martin, Chmn., FCC, CC Docket No. 01-92 (filed July 24, 2006) (NARUC Task Force July 24, 2006 *Ex Parte* Letter).

[486] *Comment Sought on Missoula Intercarrier Compensation Reform Plan*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 8524 (2006). Subsequently, the Missoula Plan supporters filed additional details concerning specific aspects of the plan, on which the Commission continued to seek comment. *See Comment Sought on Missoula Plan Phantom Traffic Interim Process and Call Detail Records Proposal*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 13179 (2006); *Comment Sought on Amendments to the Missoula Plan Intercarrier Compensation Proposal to Incorporate a Federal Benchmark Mechanism*, CC Docket No. 01-92, Public Notice, 22 FCC Rcd 3362 (2007).

[487] The Commission invited parties to refresh the record in these and other relevant dockets. *Interim Cap Clears Path for Comprehensive Reform: Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

filing of the Missoula Plan, and the more recent proposals that have been filed, the Commission has compiled an extensive record over the past seven years. The Commission has received comments or proposals from a wide variety of interested parties, including, states, incumbent LECs, competitive LECs, rural companies, IXCs, new technology companies, consumer advocates, business customers, and industry associations. As demonstrated throughout this order, the Commission has thoroughly reviewed and analyzed the voluminous record, has considered the evidence submitted by the parties supporting the alternatives, and has carefully evaluated each of the proposals that have been presented. Based on this examination of the options, we find that the approach we describe below and adopt in this order best achieves the goals of promoting universal service, encouraging the efficient use of, and investment in, broadband technologies, spurring competition, and ultimately, further reducing the need for regulation.

2. A New Approach to Intercarrier Compensation

183. Since the introduction of competition into long-distance telephone service, the Commission has moved toward eliminating implicit subsidies from intercarrier charges. At every stage, however, the Commission has had to balance the desire to establish more efficient intercarrier charges against the potential adverse effects on consumers (in the form of higher flat-rated charges) and carriers (in the form of reduced intercarrier revenues). The introduction of competition into local telephone markets accelerated the need for reform. As discussed above, since the implementation of the 1996 Act, not only has local competition increased, but so has the incidence and severity of regulatory arbitrage.

184. We conclude today that, with the universal service fund now stabilized, we can wait no longer to begin the process of comprehensive intercarrier compensation reform. The differences in existing intercarrier compensation regimes impose significant inefficiencies on users and distort carriers' investment incentives, which can result in losses of billions of dollars in consumers and producers surplus. Possibly more important, these legacy regulatory regimes pose an obstacle to the transition to an all-IP broadband world. Because carriers currently can receive significant revenues from charging above-cost rates to terminate telecommunications traffic, they have a reduced incentive to upgrade their networks to the most efficient technology or to negotiate interconnection agreements that are designed to accommodate the efficient exchange of IP traffic, as both actions would likely lead to reduced intercarrier payments.[488]

185. In this order, we therefore adopt a new approach to intercarrier compensation and establish the blueprint for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we recognize, as the Commission has in the past, the need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan with separate stages, designed to reduce rates over a sufficient period to minimize market

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[488] *See, e.g.*, T. RANDOLPH BEARD & GEORGE S. FORD, DO HIGH CALL TERMINATION RATES DETER BROADBAND DEPLOYMENT? (Phoenix Center Policy Bulletin No. 22, Oct. 2008), *available at* http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf.

disruptions and to cushion the impact of our reform on both customers and carriers. At the end of the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

186. The requirements that we adopt for intercarrier compensation do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions. We find that these areas have very different attributes and related cost issues than the continental states.[489] For this reason, we are exempting providers in Alaska, Hawaii and U.S. Territories and possessions from the requirements and rules adopted herein, and we will address them in a subsequent proceeding.[490]

187. *Transition Plan.* As described below, we adopt a ten-year transition plan.[491] In the first stage, intrastate

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[489] *See, e.g., Verizon/América Móvil Transfer Order*, 22 FCC Rcd at 6211, para. 36 (describing "difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Rates and Services Integration Order*, 4 FCC Rcd at 396, paras. 7-8 (describing the unique market conditions and structure in Alaska); GCI Oct. 3, 2008 *Ex Parte* Letter (citing cost distinctions between Alaska and the continental United States).

[490] *Cf. Policies and Service Rules for the Broadcasting-Satellite Service Order*, 22 FCC Rcd at 8860, para. 47 ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[491] A number of parties argue for a shorter transition period than that provided here. *See, e.g.*, Letter from Robert W. Quinn, Senior Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Oct. 23, 2008) (AT&T Oct. 23, 2008 *Ex Parte* Letter); Letter from Kyle McSlarrow, President and CEO, NCTA, to Kevin J. Martin, Chairman, FCC, CC

access rates are reduced to the levels of interstate rates. During stage two, carriers will reduce their rates to an interim uniform termination rate, set by the state. Carriers whose current rates are below the interim uniform rate set by the state, however, may not increase their rates. During stage three, the rates carriers charge at the end of stage two (either the interim uniform rates or their prior rates, whichever are lower) will be gradually reduced to the rates that will apply at the end of the transition. This transition will be designed by the state so as to minimize market disruptions and adverse economic effects. This transition is described in more detail below.

188. *Intrastate Rate Reductions.* One year from the effective date of this order, we require that all LECs reduce their terminating *intrastate* switched access rates by 50 percent of the difference between their intrastate switched access rates and their *interstate* switched access rates.[492] Two years from the effective date of this order, we require that all LECs reduce their terminating

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Docket No. 01-92 (filed Oct. 28, 2008) (NCTA Oct. 28, 2008 *Ex Parte* Letter); Letter from Paul W. Garnett, Assistant Vice-President, CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed October 27, 2008) (CTIA October 27, 2008 *Ex Parte* Letter); Small Business Administration Office of Advocacy (SBA) *ICC FNPRM* Comments at 5-7. We note that the reforms adopted today do not preclude carriers from entering into agreements that would reduce intercarrier charges more quickly, (*See, e.g.*, Letter from Susanne A. Guyer, Senior Vice-President, Verizon, to Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed October 28, 2008) at 6.) nor do they prevent state commissions from accelerating the glide path toward the final reciprocal compensation rate if they deem it appropriate.

[492] To the extent that a carrier's intrastate terminating access rate already is below its interstate terminating access rate, it will not change that rate.

intrastate switched access rates by the remaining 50 percent of the difference between their intrastate switched access rates and their interstate switched access rates so that their intrastate rates equal their interstate rates. Carriers will comply with state tariffing requirements or other applicable state law in effectuating those changes in intrastate terminating access rates.

189. *State Establishment of Interim, Uniform Reciprocal Compensation Rates.* Within two years from the effective date of this order, states must adopt a statewide interim, uniform reciprocal compensation rate applicable to all carriers (except carriers whose rates are below the interim, uniform rate, in which case, those carriers' rates shall be capped at those lower, existing rates). Three years from the effective date of this order, we require that all LECs reduce their terminating rates by 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state. Four years from the effective date of this order we require that all LECs reduce their terminating rates by the remaining 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state so that their terminating rates equal the state-set interim, uniform reciprocal compensation rate. This rate will become the starting point for stage three—a six-year gradual downward transition to the final uniform reciprocal compensation rate, which the states will also set, consistent with the methodology we adopt in this order. The states will have discretion to determine the glide path, which begins four years from the effective date of this order and ends ten years from the effective date of this order. This glide path will determine the trajectory of the interim reciprocal compensa-

tion rate as it trends down to the final reciprocal compensation rate. All carriers are subject to this glide path. However, if a carrier's rate is below the rate specified in the glide path, such carrier cannot raise its rates, but is subject to the trajectory when the interim rate equals that carrier's rate. At the end of ten years (i.e., at the end of stage two), all the terminating rates of all carriers in each state will be reduced to the new final, uniform reciprocal compensation rate established by each state. We believe that, by establishing this ten-year, multiple-stage transition to a state-set final uniform reciprocal compensation rate, we will provide a sufficiently smooth and gradual glide path so that carriers will be able to adjust their other rates and revenues in a measured way over time, as allowed by the reforms adopted in this order, without creating unacceptable rate or revenue effects.

190. Although we permit the states to establish the particular interim, uniform reciprocal compensation rate for each step of the final six years of the transition, we establish certain conditions on the interim, uniform reciprocal compensation rate and on the terminating intercarrier rates that carriers may charge. First, although we do not set forth a methodology that states must use in setting the interim, uniform reciprocal compensation rates, we do require that, within each state, there must be a single, state-wide interim, uniform reciprocal compensation rate during each year and at each stage of the transition.[493] Therefore, in establishing interim, uniform reciprocal compensation rates, a state may wish to consider the impact of those rates on all the carriers in the

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[493] We recognize that the state-wide interim, uniform reciprocal compensation rates may vary state-by-state as state commissions consider the best means of transitioning to a final, uniform reciprocal compensation rate.

state. States are permitted to adopt an interim, uniform reciprocal compensation rate that may be higher at the beginning of the transition than some existing incumbent LEC rates today. If they do so, however, carriers with lower termination rates may not raise them to the interim uniform rate. Second, states may determine the glide path for moving from the interim, uniform reciprocal compensation rate to the final, uniform reciprocal compensation rate, subject to the requirement that the interim uniform rate be identical for all carriers at each step in the transition. By the end of the transition period, the interim, uniform reciprocal compensation rates must decrease to a single final, uniform reciprocal compensation rate for all carriers established pursuant to the Commission's new "additional costs" methodology.

191. *Transition of Rates During Stage Three.* Beginning four years from the effective date of this order, and through the remainder of the transition, each carrier must set each of its terminating rates at the lower of: (i) its current rate; or (ii) the state-set interim, uniform reciprocal compensation rate applicable at that stage of the transition. Thus, for example, if a carrier has an interstate terminating access rate above the interim, uniform reciprocal compensation rate applicable at that stage of the transition, but a current reciprocal compensation rate below the interim, uniform reciprocal compensation rate, the carrier will reduce its interstate rate to the interim rate but leave its current reciprocal compensation rate unchanged. That carrier will continue to have two separate termination rates until such time as the applicable interim, uniform reciprocal compensation rate is adjusted lower and becomes less than its current reciprocal compensation rate. At that time, all the carrier's rates will be

set at the level of the interim, uniform reciprocal compensation rate for that state.

192. We emphasize that under no circumstances shall a carrier be permitted to increase its current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates. In this respect, the applicable interim, uniform reciprocal compensation rate set by the states will act as a ceiling or cap on such rates. We do not permit a carrier to charge a rate for terminating interstate or intrastate access, reciprocal compensation, or ISP-bound traffic that is higher than the interim, uniform reciprocal compensation rate, but we will permit a carrier to continue to charge a rate that is lower than the interim, uniform reciprocal compensation rate. We note that because CMRS providers may not tariff terminating access today,[494] and we do not permit a carrier to increase rates during the transition, CMRS providers therefore will not be permitted to charge for terminating access until the end of the transition period.[495]

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[494] Although CMRS providers may not tariff access charges, they are not prohibited from entering into contracts with interexchange carriers that provide for the payment of such charges. *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192 (2002) (*CMRS Access Charges Declaratory Ruling*).

[495] Consistent with our conclusion that CMRS providers are unable to assess access charges during the transition, we make clear that our symmetry rule, set forth in Part V.C.1.b, will not apply until the transition is over. Even so, we clarify that, to the extent that any carrier has a terminating rate above the permissible rate, such carrier must reduce the rate to the permissible level. Specifically, in the first year of the transition, all carriers with intrastate access charges higher than their interstate access charges must reduce such charges by 50 percent of the difference between its interstate

193. We note that we already have an interim intercarrier compensation regime for ISP-bound traffic, and to avoid disruption in the marketplace, we will apply on a transitional basis the pricing standards we adopted for ISP-bound traffic in the *ISP Remand Order*,[496] as modified by the *Core Forbearance Order*.[497] Currently, two rules remain in effect: (1) ISP-bound traffic is currently subject to a reciprocal compensation rate cap of $.0007 per minute-of-use; and (2) under the mirroring rule, the $.0007 cap applies to traffic exchanged with an incumbent LEC only if it offers to exchange all traffic subject to section 251(b)(5) at the same rate. As explained below, we conclude that it is appropriate to retain these rules, but only on a transitional basis until a state commission, applying the "additional costs" standards adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

194. In the *ISP Remand Order* in 2001, based on "convincing evidence in the record" that carriers had "targeted ISPs as customers merely to take advantage of . . . intercarrier payments"—offering free service to ISPs, paying ISPs to be their customers, and sometimes

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switched access rate and its intrastate switched access rate. Similarly, once the state-set interim, uniform rate is in effect, all carriers must reduce terminating rates, whether interstate access, reciprocal compensation, or ISP-bound traffic, by 50 percent of the difference between the current terminating switched access rate and the interim, uniform rate (as it is reduced over time). Even though rates during the transition will not reflect true symmetry, rates for most carriers should be symmetric before the transition is over as all carriers reduce charges to the final, uniform rate.

[496] *See ISP Remand Order*, 16 FCC Rcd at 9153, 9186-93, paras. 21, 77-88.

[497] *See Core Forbearance Order*, 19 FCC Rcd at 20184-89, paras. 16-26.

engaging in outright fraud—the Commission adopted an interim ISP payment regime to "limit, if not end, the opportunity for regulatory arbitrage."[498] The Commission adopted a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use.[499] These rate caps reflected the downward trend in intercarrier compensation rates contained in then-recently negotiated interconnection agreements.[500] We have previously recognized that evidence that "carriers have agreed to rates"—through voluntary, arms-length negotiations—constitutes substantial evidence that rates are just and reasonable.[501]

195. Most commenters urge the Commission to maintain the interim compensation rules governing ISP-bound traffic until the Commission is able to transition to

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[498] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 77.

[499] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

[500] *ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85.

[501] *ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85; *see also Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, WC Docket No. 05-281, 22 FCC Rcd 1958, 1984-85, paras. 39, 40 n.136 (2007) (finding that "commercially negotiated rates" provide "just and reasonable prices"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 98-147, 96-98, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17389, para. 664 (2003) (subsequent history omitted) (*Triennial Review Order*) (finding that "arms-length agreements . . . to provide [an] element at [a] rate" "demonstrate[s]" that the rate is "just and reasonable").

comprehensive intercarrier compensation reform.[69] These parties contend that a higher compensation rate

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[69] *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 10 (filed July 8, 2008) (asking the Commission to maintain the existing compromises reached with respect to ISP-bound traffic); Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68 at 8 (filed May 9, 2008) (asserting that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform); Letter from L. Charles Keller, Counsel for Sage Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 99-68, 01-92, Attach. at 6 (Sage Telecom May 9, 2008 *Ex Parte* Letter) (stating that retaining the ISP rate serves broad policy goals); Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 1 (filed May 7, 2008) (supporting continuation of the interim compensation rules); Letter from Joshua Seidmann, Vice President of Regulatory Affairs, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 2 (filed Apr. 28, 2008) (ITTA Apr. 28, 2008 *Ex Parte* Letter) (asking the Commission to retain the current $0.0007 rate for ISP-bound traffic); Letter from Donna Epps, Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 at 1 (filed Apr. 7, 2008) (urging the Commission to support its earlier finding that $0.0007 is appropriate compensation for dial-up ISP traffic); Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, Attach. (filed May 1, 2008) (describing how elimination of the existing ISP rate would create substantial burdens on a number of carriers and state commissions) (Verizon Wireless May 1, 2008 *Ex Parte* Letter); Letter from Glenn Reynolds, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-262, WC Docket No. 07-135 at 2 (filed Apr. 29, 2008) (noting that the Commission's existing rules have "largely mitigated the debate around compensation for ISP-bound traffic, but there is every reason to believe the same problems would arise if the Commission were to reverse direction on this issue") (USTelecom Apr. 29, 2008 *Ex Parte* Letter).

would create new opportunities for arbitrage[165] and impose substantial financial burdens on wireless companies, incumbent LECs and state public utility commissions.[166] They further claim that the existing regime has simplified interconnection negotiations.[167]

196. We share these commenters' concerns. The record also suggests that eliminating the $.0007 cap and instead applying higher reciprocal compensation rates that may be set by the states during the transition period to the adoption of our new methodology would have a significant negative impact on carriers serving rural markets and broadband deployment.[168] The record demonstrates that dial up minutes remain at high levels in rural areas and that the application of reciprocal com

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[165] *See, e.g.*, USTelecom Apr. 29, 2008 *Ex Parte* Letter at 2; Letter from Melissa E. Newman, Vice President, Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, WC Docket No. 07-135, Attach. at 3-5 (filed Apr. 25, 2008) (Qwest April 25, 2008 *Ex Parte* Letter); Verizon and BellSouth, Further Supplemental White Paper on ISP Reciprocal Compensation at 20 (Verizon/BellSouth Further Supp. ISP White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004).

[166] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter, Attach.

[167] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter (stating that "the [m]irroring [r]ule simplified wireless-ILEC interconnection negotiations tremendously."); Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Docket Nos. 01-92, 96-98, 99-68 at 38-40 (filed Oct. 2, 2008) (Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments) (indicating that Verizon entered into multiple agreements using the $.0007 rate cap established in the *ISP Remand Order*).

[168] *See, e.g.*, ITTA April 28, 2008 *Ex Parte* Letter, Attach. at 3, 5; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 2, 5-7.

pensation to these minutes would generate significant costs to carriers serving these rural areas.[507] Thus, it remains the case that the "rate caps help avoid arbitrage and market distortions that otherwise would result from the availability of reciprocal compensation for ISP-bound traffic."[508] We further believe that maintaining the cap on a transitional basis will minimize the disruptive effects and regulatory uncertainty that otherwise would result from the abrupt elimination of clear compensation rules for ISP-bound traffic.

197. We expect that state commissions, applying the new "additional costs" standard adopted in this order, will set final reciprocal compensation rates at or below $.0007 per minute-of-use. As noted below, the evidence

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[507] *See, e.g.*, Letter from Tamar E. Finn, Counsel for Earthlink, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at iii, 11-12 (filed Aug. 14, 2008) (estimating that 24% of dial-up users in rural America say that broadband service is not available where they live); Sage Telecom May 9, 2008 *Ex Parte* Letter at 3-4; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 6 (calculating its cost to be $100 million if all ISP-bound minutes were subject to TELRIC-based rates under section 251(b)(5)); ITTA Apr. 28, 2008 *Ex Parte* Letter (noting that dial-up usage remains strong in rural areas); USTelecom Apr. 29, 2008 *Ex Parte* Letter (noting a "recent study from the Pew Internet & American Life Project that indicated that while the number of dial-up subscribers had dropped 63% since 2001, the number of minutes spent online by each dial-up subscriber had increased approximately 70%. As a result, some USTelecom member companies are actually seeing an *increase* in dial-up minutes.") (emphasis in original); Letter from Bennett L. Ross, General Counsel—D.C., BellSouth D.C., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 03-171 (filed Aug. 29, 2005) (attaching a chart showing that "dial-up subscribers would continue to generate substantial minutes of dial-up ISP calls, notwithstanding projections of a continued decline in the number of dial-up subscribers.").

[508] *Core Forbearance Order*, 19 FCC Rcd at 20815-16, para. 18.

in the record suggests that the incremental cost of call termination on modern switches is de minimis.[509] We have given state commissions up to ten years to transition to new rates based on the "additional costs" standard. Accordingly, the rate cap will only have an impact in a particular state on a transitional basis until that state sets rates at or below $.0007.

198. The mirroring rule has also succeeded in promoting the Commission's "goal of a more unified intercarrier compensation regime by requiring LECs to offer similar rates for like traffic."[510] Most intraMTA traffic is now exchanged pursuant to the rate caps, and a substantial portion of wireline intraexchange traffic is being exchanged at rates at or below the rate caps as well.[511] Eliminating the mirroring rule and allowing carriers to charge higher transitional reciprocal compensation rates for traffic currently subject to the mirroring rule would significantly increase the cost carriers incur in exchanging that traffic. Those increased costs would divert funds from investment in next generation wireless networks and likely would be borne by consumers, through increases in the costs of wireless offerings.[512]

199. We reject arguments that the Commission unlawfully delegated its authority in the *ISP Remand Order* and arguments that the Commission addressed previously in the *Core Forbearance Order*.[513] We also dis-

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[509] *See infra* para. 250.

[510] *Core Forbearance Order*, 19 FCC Rcd at 20816, para. 19.

[511] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

[512] Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

[513] *See* Letter from Michael B. Hazzard, Counsel for Core Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at 18 & n.8 (filed May 14, 2008) (Core May 14, 2008

agree with parties who suggest that the Commission, in responding to the D.C. Circuit's remand in *WorldCom*, must offer detailed new justifications for each of the four features of the ISP intercarrier payment regime: the rate caps, the mirroring rule, the growth cap, and the new markets rule.[514] The prior policy justifications offered for those rules by the Commission have not been overturned by any court, and our current policy justification for retaining these rules is simply to maintain the status quo in this area on a transitional basis until our new "additional costs" methodology has been fully implemented. Indeed, pursuant to our new "additional costs" methodology, we believe that the rate caps set forth in 2001 may well be higher than the final, uniform reciprocal compensation rates set by the states. However, discarding these rules during the transition to our new methodology would be unwise and unwarranted because the "rate caps are necessary to prevent discrimination *between* dial-up Internet access customers and basic telephone service customers," those caps "protect consumers of basic telephone service" from being forced to subsidize dial-up Internet access service, and the rate caps minimize the "classic regula-

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Ex Parte Letter). We also reject Core's argument that the *ISP Remand Order* unlawfully delegates to incumbent LECs the decision of whether the *ISP Remand Order* applies. *See id.* at 19-20. The Commission did not delegate its authority in the *ISP Remand Order* but rather provided options that were not mandatory. *See, e.g.*, *ISP Remand Order*, 16 FCC Rcd at 9193, para. 89. Additionally, Core argues that the Commission provided no reasoned explanation for the growth cap and new market rules adopted in the *ISP Remand Order* and never provided notice or an opportunity for comment on those specific rules. These rules, as applicable to all carriers, were forborne from in the *Core Forbearance Order*. *See Core Forbearance Order*, 19 FCC Rcd at 20186-87, paras. 20-21. As such, this argument is moot.

[514] *See* Core May 14, 2008 *Ex Parte* Letter, Attach. at 20-26.

tory arbitrage" that reciprocal compensation for ISP-bound traffic had made possible.[515]

200. In sum, we maintain the $.0007 cap and the mirroring rule, on a transitional basis, pursuant to our section 201 authority. These interim rules shall remain in place in a state until the state commission, applying the "additional costs" standard adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

201. We find that our transition plan is necessary and appropriate to prevent undue economic hardships to carriers caused by a too-rapid reduction in intercarrier compensation rates. If there is evidence that carriers are attempting to abuse the interim, uniform reciprocal compensation rate and/or transition process to create arbitrage opportunities, we encourage carriers to bring such evidence to our attention or that of the state commission so such claims can be investigated and, if appropriate, action taken.

3. Legal Authority

a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g)

202. The history of intercarrier compensation reveals many policy reasons for comprehensively reforming intercarrier compensation rates, including reducing arbitrage, promoting competition, facilitating the introduction of new technologies, and benefiting consumers. The dual structure of separate federal and state jurisdiction over communications has made accomplishing such reforms more complex, however. Although our reform

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[515] *In re Core Commc'ns* 455 F.3d at 277-80 (internal quotation marks omitted).

does not disturb those fundamental jurisdictional distinctions, we find that, through the tools made available by the 1996 Act, we have the means to accomplish this reform by electing to partner with the states.

203. The Commission unquestionably has authority to reform intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and IP/PSTN traffic. Section 2(a) of the Act establishes the Commission's jurisdiction over interstate services, for which the Commission ensures just, reasonable, and not unjustly and unreasonably discriminatory rates under section 201 and 202.[516] Likewise, the Commission has authority over the rates of CMRS providers pursuant to section 332 of the Act.[517] We also make clear that authority to impose economic regulation with respect to IP/PSTN traffic rests exclusively with this Commission. The Commission has adopted a number of regulatory requirements applicable to interconnected VoIP services and providers.[518] With respect to the statutory classifica-

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[516] 47 U.S.C. §§ 152(a), 201, 202.

[517] 47 U.S.C. § 332.

[518] *See, e.g., Telephone Number Requirements for IP-Enabled Services Providers; Local Number Portability Porting Interval and Validation Requirements; IP-Enabled Services; CTIA Petitions for Declaratory Ruling on Wireline-Wireless Porting Issues*, CC Docket Nos. 99-200, 95-116, WC Docket Nos. 07-243, 07-244, 04-36, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, 19538-40, paras. 14, 16 (2008) (*LNP Order*) (imposing LNP requirements, and noting that the Commission previously imposed the requirement to provide 911 service, to contribute to universal service, to protect the privacy of customers, to comply with disability access and telecommunications relay service requirements, and to satisfy certain CALEA obligations).

tion of IP-enabled services, however, the Commission only has addressed two situations.[519]

204. We now classify as "information services" those services that originate calls on IP networks and terminate them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks (collectively "IP/PSTN" services).[520] Such traffic today involves a net protocol

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[519] On one hand, the Commission classified as an "information service" Pulver.com's free service that did not provide transmission and offers a number of computing capabilities. *Petition for Declaratory Ruling that Pulver.com's Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, WC Docket No. 03-45, Memorandum Order and Opinion, 19 FCC Rcd 3307 (2004) (*Pulver.com Order*). On the other hand, the Commission found that certain "IP-in-the-middle" services were "telecommunications services" where they: (1) use ordinary customer premises equipment (CPE) with no enhanced functionality; (2) originate and terminate on the public switched telephone network (PSTN); and (3) undergo no net protocol conversion and provide no enhanced functionality to end users due to the provider's use of IP technology. *See, e.g., Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 (2004) (*IP-in-the-Middle Order*). *See also, e.g., Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, *Declaratory Ruling* and Report and Order, 21 FCC Rcd 7290 (2006) (*Prepaid Calling Card Order*).

[520] We use the term "IP/PSTN" as a shorthand, without reaching any universal conclusions regarding the technology underlying the PSTN. Today the PSTN continues to rely primarily on circuit-switched technology to connect to end-user customers, although we recognize that carriers increasingly are converting portions of their networks to IP technology. *See, e.g., IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers*, WC Docket Nos. 04-36, 05-196, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, 10258, para. 24 & n.77 (2005) (distinguishing the "specialized" CPE required for interconnected VoIP services from the standard CPE used for typical telephone calls); *Federal-*

conversion between end-users, and thus constitutes an "enhanced" or "information service."[621]

State Joint Board on Universal Service, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11532, para. 84 (1998) ("'IP telephony' services enable real-time voice transmission using Internet protocols. The services can be provided in two basic ways: through software and hardware at customer premises, or through 'gateways' that enable applications originating and/or terminating on the PSTN. Gateways are computers that transform the circuit-switched voice signal into IP packets, and vice versa, and perform associated signaling, control, and address translation functions."). Insofar as a service allows a customer to originate a communication on an IP network and terminate it on a circuit-switched network, or vice versa, it involves a net protocol conversion, and we classify it as an "information service" today. Insofar as that service allows communications with no net protocol conversion, it is not subject to our "information service" classification here. We note that the presence of a net protocol conversion is not the only basis for classifying a service as an "enhanced" or "information service." *See, e.g.*, 47 C.F.R. § 64.702(a); *Computer II Final Decision*, 77 FCC 2d at 420-21, para. 97. We do not reach those issues at this time, however.

[621] *See, e.g., Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21957-58, para. 106 (1996) (*Non-Accounting Safeguards Order*). Interpreting the 1996 Act's definition of "information services," the Commission held that "all of the services that the Commission has previously considered to be 'enhanced services' are 'information services.'" *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21956, para. 103. For the all reasons discussed in Part V.B.2, we decline to defer the classification of IP/PSTN services, as requested by some parties, instead finding it appropriate to address this issue as part of our comprehensive reforms. *See, e.g.*, Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, CC Docket Nos. 96-45, 01-92 at 15 (filed Oct. 24, 2008) (Free Press Oct. 24, 2008 *Ex Parte* Letter); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Broadview Networks, et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008).

205. Although there are certain exceptions to this treatment, we do not find them applicable.[522] In particular, we do not find this to be "protocol conversion in connection with the introduction of new technology to implement existing services" that would be treated as a "basic," rather than "enhanced" service.[523] That exception was designed to address situations "involving no change in an existing service, but merely a change in electrical interface characteristics to facilitate transitional introduction of new technology."[524] By contrast, we find that IP/PSTN services are not mere changes to the underlying technology used for "existing" basic services, but are entirely new services with characteristics in

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[522] Two of the exceptions are: (1) protocol processing involving communications between an end user and the network itself (*e.g.*, for initiation, routing, and termination of calls) rather than between or among users; and (2) protocol conversion to facilitate the interconnection of networks. *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957-58, para. 106. These categories of protocol processing services may involve protocol conversions, but they result in no net protocol conversion between the end users. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, Order on Reconsideration, 12 FCC Rcd 2297, 2297-99, para. 2 (1997). Thus, they are not relevant here.

[523] *Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Phase II Carrier Service and Facilities Authorization Thereof; Communications Protocols Under Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 85-229, Report and Order, 2 FCC Rcd 3072, 3081, para. 65 (1987) (*Computer III Phase II Order*). *See also Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957-58, para. 106.

[524] *Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, GN Docket No. 80-756, Memorandum Opinion, Order, and Statement Of Principles, 95 FCC 2d 584, para. 16 (1983) (*Protocols Order*).

many ways distinct from preexisting telephone services.[525]

206. Consistent with the *Pulver.com Order* and the *Vonage Order*, we preempt any state efforts to impose "traditional 'telephone company' regulations" as they relate to IP/PSTN information services as inconsistent with our generally unregulated treatment of information services.[526] Of course, neither the *Vonage Order*, the *Pul-*

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[525] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 9-11 (filed Sept. 19, 2008); Letter from Susanne A. Guyer, Senior Vice President, Federal Regulatory Affairs, Verizon, to Chairman Kevin J. Martin, FCC, WC Docket No. 04-36, at 10-11 (filed Aug. 6, 2007); Letter from AT&T et al., to Chairman Kevin J. Martin, FCC, et al., WC Docket No. 04-36, CC Docket No. 01-92 at 2-3 (filed Aug. 6, 2008); VON Coalition *IP-Enabled Services NPRM* Comments at 3-16; AT&T *IP-Enabled Services NPRM* Comments at 13-17. We thus disagree with parties who suggest, in essence, that IP/PSTN services are no different than "basic" services. *See, e.g.*, Letter from Thomas Jones and Jonathan Lechter, Counsel for tw telecom et al., to Marlene H Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 99-68, 04-36, Attach. at 2 (filed Oct. 28, 2008) (tw telecom *et. al* Oct. 28, 2008 *Ex Parte* Letter). We note that whether a service is viewed by consumers as a possible substitute for a "basic" service is a distinct question from whether, as a matter of technology and the nature of the service offering, the service simply replaces the technology underlying a preexisting basic service. Thus, our conclusion here is not inconsistent with the Commission's recognition that interconnected VoIP services increasingly are viewed by consumers as a substitute for traditional telephone services. *See, e.g.*, *LNP Order*, 22 FCC Rcd at 19547, para. 28.

[526] *Vonage Order*, 19 FCC Rcd at 22404; *see also Pulver.com Order*, 19 FCC Rcd at 3316, para. 15 ("We determine, consistent with our precedent regarding information services, that FWD is an unregulated information service and any state regulations that seek to treat FWD as a telecommunications service or otherwise subject it to pub-

ver.com Order, nor our actions here preempt state actions that are consistent with federal policy.[627] Moreover, as we describe below, we allow states to establish reciprocal compensation rates, pursuant to our methodology, including for IP/PSTN traffic.

207. In sections 251 and 252 of the Act, Congress altered the traditional regulatory framework based on jurisdiction by expanding the applicability of national rules to historically intrastate issues and state rules to historically interstate issues.[628] In the *Local Competition First Report and Order*, the Commission found that the 1996 Act created parallel jurisdiction for the Commission and the states over interstate and intrastate matters under sections 251 and 252.[629] The Commission and the states "are to address the same matters through their parallel jurisdiction over both interstate and intrastate matters under sections 251 and 252."[630] Moreover, section 251(i) provides that "[n]othing in this section shall be construed

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lic-utility type regulation would almost certainly pose a conflict with our policy of nonregulation.").

[627] For example, states are free to require contributions to state universal service or telecommunications relay service funds through methodologies that are consistent with federal policy. *See, e.g.*, Letter from Robert W. Quinn, Jr. Senior Vice President, Federal Regulatory, AT&T, to Chairman Kevin J. Martin, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 96-45 at 11-16 (filed July 23, 2008) (describing ways that states could require contributions to state universal service or telecommunications relay service funds in a manner that is consistent with federal policy).

[628] *See Local Competition First Report and Order*, 11 FCC Rcd at 15544, para. 83.

[629] *Local Competition First Report and Order*, 11 FCC Rcd at 15544-45, para. 85.

[630] *Local Competition First Report and Order*, 11 FCC Rcd at 15546-47, para. 91.

to limit or otherwise affect the Commission's authority under section 201."[631] The Commission concluded that section 251(i) "affirms that the Commission's preexisting authority under section 201 continues to apply for purely interstate activities."[632]

208. In implementing sections 251 and 252 in the *Local Competition First Report and Order*, the Commission's treatment of LEC-CMRS traffic provides an instructive approach. Prior to the 1996 Act, the Commission expressly preempted "state and local regulations of the kind of interconnection to which CMRS providers are entitled" based on its authority under section 201 and 332 of the Act.[633] Nevertheless, in the *Local Competition First Report and Order*, the Commission brought LEC-CMRS interconnection within the section 251 framework as it relates to intraMTA (including interstate intraMTA) traffic.[634] The Commission recognized, however, that it continued to retain separate authority over CMRS traffic.[635]

209. Courts confirmed that, in permitting LEC-CMRS interconnection to be addressed through the section 251 framework, the Commission did not in any way

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[631] 47 U.S.C. § 251(i).

[632] *Local Competition First Report and Order*, 11 FCC Rcd at 15546-47, para. 91.

[633] *Implementation of Sections 3(n) and 332*, Second Report and Order, 9 FCC Rcd 1411, 1498, para. 230 (1994).

[634] *See Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023.

[635] *Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023 ("By opting to proceed under sections 251 and 252, we are not finding that section 332 jurisdiction over interconnection has been repealed by implication, or rejecting it as an alternative basis for jurisdiction.").

lose its independent jurisdiction or authority to regulate that traffic under other provisions of the Act. Thus, although the Eighth Circuit invalidated the Commission's TELRIC pricing rules in general,[536] it recognized that "because section 332(c)(1)(B) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers, [including the reciprocal compensation rules] but only as these provisions apply to CMRS providers. Thus, [the pricing] rules . . . remain in full force and effect with respect to the CMRS providers, and our order of vacation does not apply to them in the CMRS context."[537] Subsequently, the D.C. Circuit held that CMRS providers were entitled to pursue formal complaints under section 208 of the Act for violations of the Commission's reciprocal compensation rules.[538]

210. We build upon our actions in the *Local Competition First Report and Order*, and now permit states to establish a uniform reciprocal compensation rate, in accordance with the new methodology we establish in this order, pursuant to the section 251(b)(5) and 252(d)(2) framework. In particular, section 251(b)(5) imposes on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of tele

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[536] We note that the Supreme Court later reversed this decision and affirmed the TELRIC methodology. *See Verizon v. FCC*, 535 U.S. at 467.

[537] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (*Iowa Utils. I*), *rev'd in part and remanded on other grounds*, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366.

[538] *Qwest Corp. v. FCC*, 252 F.3d 462, 465-66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. I* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion).

communications."[539] Section 252(d)(2)(A) sets forth an "additional costs" standard that state commissions, in arbitrating interconnection disputes involving incumbent LECs, should apply in setting the "charges for transport and termination of traffic."[540] Although we allow states to set new uniform termination rates under this framework, pursuant to our methodology, we retain our authority under section 201 to find that reciprocal compensation charges are unjust and unreasonable as they relate to interstate, CMRS, and IP/PSTN traffic within our jurisdiction.[541] We expect that states will faithfully implement the pricing standards adopted in this order, and thus it will not be necessary for us to exercise that authority.[542]

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[539] 47 U.S.C. § 251(b)(5).

[540] 47 U.S.C. § 252(d)(2)(A).

[541] *See supra* paras. 203-09. *See also, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92 at 9-11 (filed on Aug. 18, 2008) (Level 3 Aug. 18, 2008 *Ex Parte* Letter). Contrary to Verizon's claims, we thus find no tension between permitting states to set reciprocal compensation rates for interstate traffic under the section 251 and 252 framework and the Commission's continuing authority over traffic subject to its jurisdiction, including section 201 authority expressly preserved under section 251(i).

[542] We recognize that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking." *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and *Order*, 12 FCC Rcd 16606, 16619-20, para. 44 (*Access Charge Reform Second Order*) (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)). In this order, we adopt an incremental cost methodology for setting termination rates. We find that the proper application of that methodology produces rates that are "just and reasonable" under section 201. As discussed below, we find it appropriate to adopt a transition before carriers

211. The Commission unquestionably has authority to interpret and adopt rules implementing sections 251(b)(5) and 252(d)(2). Congress delegated to the Commission the task of administering the Communications Act. Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[643] "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'"[644] The Commission's rulemaking authority is not limited to interstate matters; it extends to all provisions of the Communications Act.[645]

212. In addition, we find that the section 251(b)(5) and 252(d)(2) framework is broad enough to facilitate our intercarrier compensation reform. We acknowledge that, in the *Local Competition First Report and Order*, the Commission found that section 251(b)(5) applies only to local traffic,"[646] and some commenters continue to press for such an interpretation.[647] As other commenters rec-

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begin charging rates set pursuant to our incremental cost methodology.

[643] 47 U.S.C. § 201(b) ("The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.").

[644] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378.

[645] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

[646] *Local Competition First Report and Order*, 11 FCC Rcd at 16012-13, para. 1033.

[647] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24-32; Letter from Daniel Mitchell, Vice President, Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket

ognize, however, the Commission, in the *ISP Remand Order*, reconsidered that judgment and concluded that it was a mistake to read section 251(b)(5) as limited to local traffic, given that "local" is not a term used in section 251(b)(5).[548] We recognize, as the Supreme Court noted in *AT&T Corp. v. Iowa Utilities Board*, that "[i]t would be a gross understatement to say that the 1996 Act is not a model of clarity."[549] Nevertheless, we find that the better view is that section 251(b)(5) is not limited to local traffic.

213. We begin by looking at the text of the statute. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the trans-

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No. 01-92 at 9 (filed Sept. 30, 2008) (NCTA Sept. 30, 2008 *Ex Parte* Letter); Verizon *ICC FNPRM* Comments at 38-42; NARUC *ICC FNPRM* Comments at 6-7; Rural Alliance *ICC FNPRM* Comments at 144-49; Cincinnati Bell *ICC FNPRM* Comments at 5-11; Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7; New York State PSC *ICC FNPRM* Comments at 7; Verizon and BellSouth, Supplemental White Paper on ISP Reciprocal Compensation, CC Docket No. 96-98, 99-68 at 16-20 (filed July 20, 2004) (Verizon/BellSouth Supp. ISP White Paper); NARUC's Initial Comments at 7 n.13 (May 23, 2004). *But see, e.g.*, ICF *ICC FNPRM* Comments at 39.

[548] *ISP Remand Order*, 16 FCC Rcd at 9166-67, para. 35. *See also, e.g.*, Qwest, Legal Authority for Comprehensive Intercarrier Compensation Reform at 2-4, *attached to* Letter from Melissa Newman, Counsel for Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 06-45, 99-68, WC Docket Nos. 04-36, 05-337, 05-195, 06-122 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Counsel for T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9-10 (filed Oct. 3, 2008); Level 3 Aug. 18, 2008 *Ex Parte* Letter at 2, 15-18; AT&T *Missoula Phantom Traffic* Reply at 35-41; Brief from Gary M. Epstein, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 29-35 (filed Oct. 5, 2004)

[549] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 397.

port and termination of telecommunications."[550] The Act broadly defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[551] Its scope is not limited geographically ("local," "intrastate," or "interstate") or to particular services ("telephone exchange service,"[552] telephone toll service,"[553] or "exchange access"[554]). We find that the traffic we elect to bring within this framework fits squarely within the meaning of "telecommunications."[555] Had Congress intended to preclude the Commission from bringing certain types of telecommunications traffic within the section 251(b)(5) framework, it could have easily done so by incorporating restrictive terms in section 251(b)(5). Because Congress used the term "telecommunications," the broadest of the statute's defined terms, we conclude that section 251(b)(5) is not limited only to the

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[550] 47 U.S.C. § 251(b)(5).

[551] 47 U.S.C. § 153(43).

[552] *Id.* at § 153(47).

[553] *Id.* at § 153(48).

[554] *Id.* at § 153(16).

[555] As discussed above, we classify IP/PSTN services as "information services." We note, however, that information services, by definition, are provided "via telecommunications," enabling us to bring IP/PSTN traffic within the section 251(b)(5) framework. 47 U.S.C. § 153(20). Moreover, given that we retain independent authority under section 201, we find it reasonably ancillary to that authority to regulate IP/PSTN services in this regard, consistent with our efforts to ensure uniform treatment of all traffic on the PSTN for intercarrier compensation purposes. Thus, IP/PSTN traffic ultimately will be subject to the final uniform reciprocal compensation rates established pursuant to the methodology adopted in this order. We maintain the status quo for this traffic during the transition, however.

transport and termination of certain types of telecommunications traffic, such as local traffic.

214. In the *Local Competition First Report and Order* the Commission concluded that section 251(b)(5) applies only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge."[556] In the *ISP Remand Order*, the Commission reversed course on the scope of section 251(b)(5), finding that "the phrase 'local traffic' created unnecessary ambiguities, and we correct that mistake here."[557] The *ISP Remand Order* noted that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)."[558] The Commission found that the scope of section 251(b)(5) is limited only by section 251(g), which temporarily grandfathered the pre-1996 Act rules governing "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers until "explicitly superseded by regulations prescribed by the Commission."[559] On appeal, the D.C. Circuit left intact the Commission's findings concerning the scope of section 251(b)(5), although it took issue with other aspects of the *ISP Remand Order*.[560]

215. We agree with the finding in the *ISP Remand Order* that traffic encompassed by section 251(g) is ex-

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[556] *Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033.

[557] *ISP Remand Order*, 16 FCC Rcd at 9173, para. 46.

[558] *ISP Remand Order*, 16 FCC Rcd at 9167, para. 34.

[559] 47 U.S.C. § 251(g).

[560] *See WorldCom*, 288 F.3d at 429.

cluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope. Section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation."[561] There would have been no need for Congress to have preserved these compensation rules against the effects of section 251 if the scope of section 251(b)(5) was not broad enough for the Commission to bring within its scope the traffic covered by section 251(g), i.e., access traffic. Because Congress is presumed not to have wasted its breath, particularly with a provision as lengthy and detailed as section 251(g), we find that section 251(g) confirms that section 251(b)(5) applies to the transport and termination of all telecommunications traffic exchanged with LECs, including ISP-bound traffic. And because section 251(g) "is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act,"[562] we clearly have authority under the Act to adopt regulations superseding that regime. We exercise that authority today.[563]

216. By placing all traffic under the umbrella of one compensation scheme, we eliminate jurisdictional and

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[561] 47 U.S.C. 251(g).

[562] *WorldCom*, 288 F.3d at 430.

[563] Verizon notes that although the Commission in the *ISP Remand Order* deleted the word "local" from its regulations governing reciprocal compensation, the regulations continued to exclude access services from the scope of section 251(b)(5). *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24-32; 47 C.F.R. § 51.701(b)(1). At that time, it made sense to retain the access exemption because the Commission had not issued rules superseding the access regime preserved by section 251(g). We supersede the grandfathered access regime in this order, at least in part.

regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions.[564] Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis. These artificial distinctions distort the telecommunications markets at the expense of healthy competition. Similar types of traffic should be subject to similar rules. Similar types of functions should be subject to similar cost recovery mechanisms. We achieve that result by moving away from the regime preserved by section 251(g) and bringing that traffic within the section 251(b)(5) framework.

217. We disagree with commenters who argue that section 251(b)(5) only can be applied to traffic exchanged between LECs, and not traffic exchanged between a LEC and another carrier.[565] The Commission rejected

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[564] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 12.

[565] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments ("The best interpretation of § 251(b)(5)—read in light of the text, structure, and history of the 1996 Act—is that the reciprocal compensation obligation applies only to intraexchange (or 'local') voice calls that originate on the network of one LEC (or wireless provider) and terminate on the network of another LEC (or wireless provider) operating in the same exchange (or, in the case of wireless providers, the same MTA."); Verizon and BellSouth, Internet-Bound Traffic is Not Compensable Under Sections 251(b)(5) and 252(d)(2) at 26 (Verizon/BellSouth ISP White Paper) ("By its nature, 'reciprocal compensation' must . . . apply to 'telecommunications' exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs."), *attached to* Letter from Ann D. Berkowitz,

that argument in the *Local Competition Order*, finding that section 251(b)(5) applies to traffic exchanged by a LEC and any other telecommunications carrier, and adopted rules implementing that finding.[566] In a specific application of that principle, the Commission concluded that "CMRS providers will not be classified as LECs,"[567] but nevertheless found that "LECs are obligated, pursuant to section 251(b)(5) (and the corresponding pricing standards of section 252(d)(2)), to enter into reciprocal compensation agreements with all CMRS providers."[568] No one challenged that finding on appeal, and it has been settled law for the past 12 years. We see no reason to revisit that conclusion now. Although section 251(b)(5)

Associate Director, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 (filed May 17, 2004).

[566] *See Local Competition First Report and Order*, 11 FCC Rcd at 16013-16, paras. 1034-41. *See also* 47 C.F.R. 51.703(a) ("Each LEC shall establish reciprocal compensation arrangements for transport and termination of telecommunications traffic with any requesting telecommunications carrier."); *ISP Remand Order*, 16 FCC Rcd at 9193-94, para. 89 n.177 ("Section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier . . . .").

[567] *Local Competition First Report and Order*, 11 FCC Rcd at 15996, para. 1005. In this regard, we note that, absent a determination that CMRS providers are LECs, IXC-CMRS traffic would not be encompassed by section 251(b)(5), since neither are LECs. Nevertheless, it is our intention that, at the end of the transition, CMRS providers be entitled to reciprocal compensation for all the traffic they terminate. As the Commission has observed, "[t]here are three ways in which a carrier seeking to impose charges on another carrier can establish a duty to pay such charges: pursuant to (1) Commission rule; (2) tariff; or (3) contract." *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges, Declaratory Ruling*, 17 FCC Rcd 13192, 13196, para. 8 (2002).

[568] *Local Competition First Report and Order*, 11 FCC Rcd at 15997, para. 1008.

indisputably imposes the duty to establish reciprocal compensation arrangements on LECs alone, Congress did not limit the class of potential beneficiaries of that obligation to LECs.[569]

218. We also disagree with commenters who argue that section 252(d)(2)(A)(i) limits the scope of section 251(b)(5).[570] Section 252(d)(2)(A)(i) provides that a state commission "shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless "such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[571] Verizon and others argue that this provision necessarily excludes interexchange traffic from the scope of section 251(b)(5) because at the time the 1996 Act was passed, calls neither originated nor terminated on an IXC's network.[572] We reject this reasoning because it erroneously assumes that Congress intended the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5).

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[569] If Congress had intended to limit the class of potential beneficiaries of LECs' duty to establish reciprocal obligation arrangements, it would have said so explicitly. *See* 47 U.S.C. § 251(b)(3) (describing the "duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service").

[570] *See, e.g.*, Verizon/BellSouth ISP White Paper at 41-43; New York State PSC *ICC FNPRM* Comments at 8-9; TDS *ICC FNPRM* Comments at 19 n.27; Qwest *ICC FNPRM* Comments at 39; NASUCA *ICC FNPRM* Reply at 17-18.

[571] 47 U.S.C. § 252(d)(2)(A)(i).

[572] *See, e.g.*, Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7-8; New York State PSC *ICC FNPRM* Comments at 7-10; Verizon/BellSouth Supp. ISP White Paper at 16-20; NARUC *ICC FNPRM* Comments at 7 n.13.

We do not believe that Congress intended the tail to wag the dog.

219. Section 251(b)(5) defines the scope of traffic that is subject to reciprocal compensation. Section 252(d)(2)(A)(i), in turn, deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies. Section 252(d)(2)(A)(i) provides that, at a minimum, a reciprocal compensation arrangement must provide for the recovery by each carrier of costs associated with the transport and termination on each carrier's network of calls that originate on the network of the other carrier.[573] Section 252(d)(2)(A)(i) does not address what happens when carriers exchange traffic that originates or terminates on a third carrier's network. This does not mean, as Verizon suggests, that section 251(b)(5) must be read as limited to traffic involving only two carriers. Rather, it means that there is a gap in the pricing rules in section 252(d)(2), and the Commission has authority under section 201(b) to adopt rules to fill that gap.

220. We reject Verizon's argument that a telecommunications carrier that delivers traffic to an ISP is not eligible for reciprocal compensation because the carrier does not "terminate" telecommunications traffic at the ISP.[574] In the *Local Competition Order*, the Commission defined "termination" as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises."[575] As the D.C. Circuit suggested

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[573] 47 U.S.C. § 252(d)(2)(A)(i).

[574] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 33-34; Verizon/BellSouth ISP White Paper at 31-32.

[575] *Local Competition First Report and Order*, 11 FCC Rcd at 16015, para. 1040. *See also* 47 C.F.R. § 51.701(d).

in the *Bell Atlantic* decision, "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"[676] We agree.[677] Consequently, ISP-bound traffic is subject to our new intercarrier compensation framework.[678]

221. We reject opponents' other arguments that the context and history of the 1996 Act compel a finding that section 251(b)(5) could not be applied to access traffic. Verizon argues, for example, that section 251(g) demon-

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[676] 206 F.3d at 6.

[677] Because ISP-bound traffic did not fall within the section 251(g) carve out from section 251(b)(5) as "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound Traffic," *WorldCom*, 288 F.3d at 433, ISP-bound traffic is, and always has been, subject to section 251(b)(5), although clearly interstate in nature and subject to our section 201 authority.

[678] We reject Verizon's argument against the application of section 251(b)(5) to ISP-bound traffic because this traffic is one-way traffic and as such is not reciprocal. *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 41-43. As Level 3 points out, these arguments have been rejected by the Commission and the U.S. Court of Appeals for the Ninth Circuit. *See* Level 3 Aug. 18, 2008 *Ex Parte* Letter at 18; *Pacific Bell v. Cook Telecom, Inc.*, 197 F.3d 1236, 1242-44 (9th Cir. 1999) (reciprocal compensation applies to paging traffic); *TSR Wireless, LLC v. U.S. West Commc'ns, Inc.*, 15 FCC Rcd 11166, 11178, para. 21 (2000) (the Commission's reciprocal compensation rules draw "no distinction between one-way and two-way carriers"). Because our conclusion in this order concerning the scope of section 251(b)(5) is no longer tied to whether this traffic is local or long distance, we need not address arguments made by the parties as to whether ISP-bound traffic constitutes "telephone exchange service" under the Act. *See, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 1 (filed Sept. 24, 2004). We note, however, that we retain our interim ISP-bound traffic rules. *See supra* paras. 194-200.

strates that Congress did not intend to displace the existing access pricing regime.[579] This argument ignores that Congress preserved the access regime only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[580] As noted above, we find that section 251(g) actually supports a finding that section 251(b)(5) is broad enough to cover access traffic. Verizon also argues that the reference to reciprocal compensation in the competitive checklist in section 271,[581] which was designed to ensure that local markets are open to competition, somehow shows that Congress intended to limit the scope of section 251(b)(5) to local traffic.[582] We do not see how this argument sheds any light on the scope of section 251(b)(5). Congress no doubt included the reference to reciprocal compensation in section 271 because section 251(b)(5) applies to local traffic, a point that no one disputes. That does not suggest, however, that section 251(b)(5) applies *only* to local traffic.

222. We need not respond to every other variation of the argument that the history and structure of the Act somehow demonstrate that section 251(b)(5) does not apply to access traffic. At best, these arguments show that one plausible interpretation of the statute is that section 251(b)(5) applies only to local traffic, a view that the Commission embraced in the *Local Competition First Report and Order*. These arguments do not persuade us, however, that this is the only plausible reading of the statute. Moreover, many of the same arguments based

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[579] *See* Verizon *ICC FNPRM* Comments at 41.

[580] 47 U.S.C. § 251(g).

[581] *See* 47 U.S.C. § 271(c)(2)(B)(xiii).

[582] *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 9.

on the history and context of the adoption of section 251 to limit its scope to local traffic were rejected by the D.C. Circuit in the context of section 251(c).[583] We find that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2).

223. The approach we adopt here provides a sound basis for comprehensive reform, and we thus decline to adopt alternative proposals. On one hand, we note that some commenters advocate that the Commission adopt an intercarrier compensation rate or cap of $0.0007 per minute of use for all traffic.[584] To implement this reform

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[583] *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) (*USTA II*) ("Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not 'telecommunications services' has no support."). In *USTA II*, the D.C. Circuit was addressing whether the term "telecommunications services" was limited to local telecommunications services under section 251(c), while here we consider the analogous question of whether "telecommunications" is limited to local telecommunications under section 251(b).

[584] *See, e.g.*, Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. A at 1 (filed Oct. 6, 2008); Letter from Teresa D. Bauer and Richard R. Cameron, Counsel for Global Crossing North America, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 18, 2008); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Kevin Martin et al., Commissioners, FCC, CC Docket. 01-92 at 4 (filed Sept. 12, 2008) (Verizon Sept. 12, 2008 *Ex Parte* Letter). *But see, e.g.*, Letter from Richard A. Askoff, Executive Director—Regulatory, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed

proposal, parties have suggested that it would likely be necessary for the Commission to preempt state regulation of intrastate access charges.[686] We believe that such a significant step is not currently warranted, and elect instead to allow states to continue setting rates for intrastate traffic, as well as permitting them to set rates for traffic subject to federal jurisdiction, pursuant to our methodology. We fully expect the new pricing methodology to achieve the goals of our continuing intercarrier compensation reform. On the other hand, some parties contend that the Commission should leave matters of intrastate intercarrier compensation reform entirely to the states.[687] These proposals evidence a pre-1996 Act worldview, however. Given the tools that the 1996 Act put at our disposal, we find it possible to move forward with truly comprehensive intercarrier compensation reform under an approach which still provides for a state role.

Oct. 7, 2008) ("Prescription of a nationwide uniform default rate of $0.0007 is unnecessary to solve the rate arbitrage problems identified by Verizon. It would also represent bad policy."); Letter from Lawrence Zawalick, Senior Vice President, Rural Telephone Finance Cooperative, to Kevin Martin et al., Commissioners, FCC, CC Docket 01-92 at 1 (filed Sept. 30, 2008) ("The Rural Telephone Finance Cooperative (RTFC) strongly opposes [the $0.0007] proposal.").

[685] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 14-25 (filed Sept. 19, 2008) (Verizon Sept. 19, 2008 *Ex Parte* Letter).

[686] In some cases, parties propose that the Commission make available universal service support as an "enticement" for states to reform intrastate rates, but ultimately the decisions would be left to the individual states. *See* Letter from Tom Karalis, Counsel for Rural Alliance, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Sept. 26, 2008).

224. We note that, in the *Local Competition First Report and Order*, the Commission observed that section 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such charges were prohibited under that provision of the Act.[197] Because we elect to have the states set rates under section 251(b)(5), pursuant to our methodology, we find that retention of originating charges would be inconsistent with that statutory scheme and our new regulatory approach. Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated at the conclusion of the transition to the new regime. We recognize, however, that changes to originating access charge rates may raise issues distinct from terminating charges. Moreover, several parties urge the Commission to delay any changes to originating charges.[198] For these reasons, we ask parties to comment

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[197] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042. *See also* 47 C.F.R. § 51.703(b) (stating that a "LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network").

[198] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter at 5 (asking the Commission to defer reform of originating access); Letter from Grace E. Kohl, Policy Counsel, Cox, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, CC Docket Nos. 96-45, 01-92, 99-68, 96-262 at 2 (filed Oct. 6, 2008) (supporting proposals to delay reform of originating access) (Cox Oct. 6, 2008 *Ex Parte* Letter); Letter from Brian Benison, Director –Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 05-337, 07-135, Attach. at 3 (filed Oct. 7, 2008) (describing model with "No Change to Current Structure and Rates" for originating access); Letter from Kathleen O'Brien Ham, Federal Regulatory Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 5 (filed Oct. 3, 2008); *cf.* Letter from Mary C. Albert, Assistant General Counsel, to

on the appropriate transition for eliminating originating access charges in the accompanying Further Notice.[587] Although we ask parties to comment on the appropriate transition for eliminating originating access charges, we clarify that, under the transitional mechanism we adopt today, carriers are not permitted to increase any of their current rates, including their originating access rates.[588] Thus, both interstate and intrastate originating switched access rates will remain capped at current levels until further action by the Commission addressing the appropriate transition for this traffic. This approach is consistent with our transition of terminating rates[589] and with our goal of eliminating originating access charges at the conclusion of the transition to the new regime.

b. Legal Authority for the Transition

225. Although we comprehensively reform intercarrier compensation, we do not flash cut to our new regime,

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Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, Attach. at 1 (filed Oct. 2, 2008) (urging the Commission to delay any changes to intercarrier compensation). *But see* Letter from Anna M. Gomez, Vice President, Government Affairs, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 7 (filed Oct. 1, 2008) (urging the Commission to reform originating access immediately) (Sprint Oct. 1, 2008 *Ex Parte* Letter).

[587] *See infra* para 343.

[588] This prohibition on increasing access rates also applies to the Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, and the per-minute Residual Interconnection Charge in section 69.155 of the Commission's rules. 47 C.F.R. §§ 69.153, 69.154, 69.155.

[589] *See supra* para. 194 (prohibiting carriers from increasing their current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates).

but provide for a measured transition.[592] The goal of this transition is to avoid overly rapid rate changes for consumers while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.[593] For many of the same reasons that we have authority to adopt comprehensive reform, we find that the Commission has clear authority to establish such a transitional structure to serve as a glide path to the new methodology we have developed in this order.

226. We find it reasonable to adopt a transition plan under these circumstances. As the D.C. Circuit has recognized, avoiding "market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule,"[594] and here temporary rules setting forth a glide path are needed to mitigate potentially adverse rate or revenue effects that may be caused by our comprehensive intercarrier compensation reform, including the elimination of implicit universal service subsidies in those rates. Therefore, the Commission's

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[592] *See supra* section V.B.2.

[593] This approach is consistent with Commission precedent set forth in Part V.A, which started reforming intercarrier compensation in the 1980s. There the Commission found that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end-user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act." *1983 Access Charge Order*, 93 FCC 2d at 243, para. 4. As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[594] *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002).

exercise of its authority to create a transition plan is especially appropriate here, where the Commission is acting to reconcile the Act's "implicit tension between . . . moving toward cost-based rates and protecting universal service."[595] Not surprisingly, most commenters have affirmatively recognized the need for a transitional regime.[596] Indeed, every major plan submitted to us in this proceeding, whether the Missoula plan,[597] the ICF plan,[598] Verizon's plan,[599] AT&T's plan,[600] or the plan from

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[595] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

[596] *See, e.g.*, BellSouth *ICC FNPRM* Comments at 17 ("In order to avoid the market disruption and dislocation that would be associated with instantaneous implementation of a unified plan, BellSouth proposes a two-phase transition plan."); CCG *ICC FNPRM* Comments at 2 ("Any plan that reduces access rates should be phased-in over as long a period as possible, at least for rural carriers, so these companies have time to prepare for and adjust to the economic impact."); Cincinnati Bell *ICC FNPRM* Comments at 12 ("The Commission must allow carriers the opportunity to earn this lost access revenue in the transition to a new compensation regime in order to make any regime change revenue neutral to the affected carriers."); CCAP *ICC FNPRM* Comments at 23 ("The CCAP believes that any reform of the existing intercarrier compensation regimes should take place over a three-to-five-year period . . . .").

[597] Missoula Plan, Executive Summary at 3 ("Recognizing the vast differences among carriers, the Plan creates three different transition schedules for intercarrier compensation rates.").

[598] Letter from Gary M. Epstein and Richard R. Cameron, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 2 at 3 (filed Aug. 16, 2004).

[599] Verizon Sept. 12, 2008 *Ex Parte* Letter at 9-10.

[600] Letter from Henry Hultquist, Federal Regulatory Vice-President, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach 1 at 4 (filed July 17, 2008).

CBICC,[601] ARIC,[602] NARUC,[603] or NASUCA,[604] has called for the Commission to establish an orderly transition period. We take heed of these commenters and of our statutory responsibilities to ensure a smooth transition to the new regime by setting forth a multi-stage transition plan as part of our comprehensive reform of intercarrier compensation.

227. Moreover, we have several independent sources of legal authority to adopt the transition plan established in this order. For one, section 251 explicitly contemplates our authority to adopt a transitional scheme with regard to access charges. We agree with the United States Court of Appeals for the District of Columbia Circuit that section 251(g) created a "transitional enforcement mechanism"[605] preserving the access charge regimes that predated the 1996 Act "until . . . explicitly superseded by regulations *prescribed by the Commission.*"[606] Thus, section 251(g), by its terms, anticipates

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[601] Letter from Richard M. Rindler, Counsel for CBICC, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 2.

[602] ARIC *ICC FNPRM* Comments, Attach. 1 at 33.

[603] NARUC *ICC FNPRM* Comments, Attach. C at 6.

[604] Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 1 (filed Dec. 14, 2004).

[605] *WorldCom*, 288 F.3d at 433.

[606] 47 U.S.C. § 251(g) (emphasis added). At the least, section 251(g) preserved the interstate access regime the Commission had prescribed for all carriers (*see id.* (preserving "obligations (including receipt of compensation) . . . under any . . . regulation, order, or policy of the Commission . . . .")) and the intrastate access regime the Bell Operating Companies had agreed to in the Modified Final Judgment. *See United States v. AT&T*, 552 F. Supp. at 169. Recognizing, however, that it would be "'incongruous to conclude that Congress was concerned about the effects of potential disruption to the

that the Commission may take action to end the regimes grandfathered by section 251(g), and inherent within the power to supersede the grandfathered access regime is the lesser power to prescribe regulations that determine *how* to transition to a cost-based pricing mechanism—a power that we have twice employed in the past to reduce access charges without explicitly superseding that regime.[607]

228. In addition, as the Supreme Court has further held, the Commission has authority to prescribe the requisite pricing methodology that the States will apply in setting rates under section 252(d)(2).[608] Consistent with

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interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms,'" the Commission has consistently interpreted section 251(g) to preserve the intrastate access regime predating the Act for all carriers. *ISP Remand Order*, 16 FCC Rcd at 9168 n.66 (quoting *Local Competition First Report and Order*, 11 FCC Rcd at 15869, para. 732); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) ("[I]t is clear from the Act that Congress did not intend all access charges to move to cost-based pricing, at least not immediately. The Act plainly preserves certain rate regimes already in place.").

[607] *See MAG Order*, 16 FCC Rcd 19613 (reducing interstate access charges for rate-of-return carriers); *CALLS Order*, 15 FCC Rcd 12962 (reducing interstate access charges for price-cap carriers), *aff'd in relevant part by Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d at 324 (reasoning that because the Commission had not yet superseded the pre-Act interstate access regime, it retained authority under section 201(b) to set just and reasonable rates for interstate access); *see also WorldCom*, 288 F.3d at 433 ("We will assume without deciding that under § 251(g) the Commission might modify LECs' pre-Act 'restrictions' or 'obligations,' pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption . . . .").

[608] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 384; *see also id.* at 378 ("The FCC has rulemaking authority to carry out the 'provisions of this

our authority, the Commission here is providing for a transitional regime in the public interest to smooth the transition to the new pricing standard adopted by this order. The goal of this transition is to allow gradual changes to consumer rates while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.

229. Significantly, as discussed in greater detail above, although we elect to rely on the sections 251(b)(5) and 252(d)(2) framework for reform, that does not affect the Commission's jurisdiction over traffic or services otherwise subject to federal authority.[609] With respect to interstate services, the Act has long provided us with the authority to establish just and reasonable "charges, practices, classifications, and regulations."[610] The Commission also has authority over the rates of CMRS providers pursuant to section 332 of the Act.[611] The Commission thus retains full authority to adopt transition plans for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework. Because we reaffirm our findings concerning the interstate nature of ISP-bound traffic, it follows that such traffic falls under the Commission's section 201 authority preserved by the Act.[612] This conclusion is rein-

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Act,' which include §§ 251 and 252, added by the Telecommunications Act of 1996.")

[609] *See supra* para. 207.

[610] 47 U.S.C. § 201(b).

[611] 47 U.S.C. § 332.

[612] We have consistently found that ISP-bound traffic is jurisdictionally interstate. ISP-bound traffic melds a traditional circuit-switched local telephone call over the PSTN to packet switched IP-based Internet communication to Web sites. *Declaratory Ruling*, 14 FCC Rcd at 3702, para. 18; *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. This conclusion has not been questioned by the D.C. Cir-

forced by section 251(i) of the Act. As the Commission explained in the *ISP Remand Order*, section 251(i) "expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[613] It concluded that section 251(i), together with section 201,

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cuit. *See WorldCom*, 288 F.3d at 431; *Bell Atlantic v. FCC*, 206 F.3d at 5 ("There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate"). In other contexts, the Commission has likewise found that services that offer access to the Internet are jurisdictionally interstate services. In 1998, for example, the Commission found that ADSL service is jurisdictionally interstate. *See GTE Tel. Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22481, para. 28 (1998) ("finding that GTE's ADSL service is subject to federal jurisdiction" and is "an interstate service"). More recently, the Commission has confirmed this ruling for a variety of broadband Internet access services. *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4832, para. 59 (2002) (finding that, "on an end-to-end analysis," "cable modem service is an interstate information service"); *Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14914, para. 110, *aff'd by Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.* (*Brand X*), 545 U.S. 967 (2005); *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT 07-53, Declaratory Ruling, 22 FCC Rcd 5901, 5911, para. 28 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, WC 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281, 13288, para. 11 (2006). In the *Vonage Order*, the Commission likewise found that VoIP services are jurisdictionally interstate, employing the same end-to-end analysis reflected in those other orders. *Vonage Order*, 19 FCC Rcd at 22413-14, paras. 17-18.

[613] *ISP Remand Order*, 16 FCC Rcd at 9174, para. 50.

equips the Commission with the tools necessary to keep pace with regulatory developments and new technologies.[614] When read together, these statutory sections preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic. Consequently, in the *ISP Remand Order*, the Commission properly exercised its authority under section 201(b) to issue interim pricing rules governing the payment of compensation between carriers for ISP-bound traffic.[615]

230. This result is consistent with the D.C. Circuit's opinion in *Bell Atlantic*, which concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under section 251(b)(5).[616] It is also consistent with the court's *WorldCom* decision, in which the court rejected the Commission's view that section 251(g) excluded ISP-bound traffic from the scope of section 251(b)(5), but made no other findings.[617] Finally, this result does not run afoul of the Eighth Circuit's decision on remand from the Supreme Court in the *Iowa Utilities Board* litigation, which held that "the FCC does not have the authority to set the actual prices for

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[614] *See ISP Remand Order*, at 9175, para. 51.

[615] We thus respond to the D.C. Circuit's remand order in *WorldCom*, 288 F.3d at 434, and the court's writ of mandamus in *Core Communications*, 531 F.3d at 861-62, which directed the Commission to explain its legal authority to issue the interim pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*. Specifically, we find, for the reasons set forth above and in Part V.B.3, that the Commission had the authority to adopt the interim pricing regime pursuant to our broad authority under section 201(b) to issue rules governing interstate traffic.

[616] *See Bell Atlantic*, 206 F.3d at 5.

[617] *See WorldCom*, 288 F.3d at 434.

the state commissions to use" under section 251(b)(5).[618] At the time of that decision, under the *Local Competition First Report and Order*, section 251(b)(5) applied only to local traffic. Thus, the Eighth Circuit merely held that the Commission could not set reciprocal compensation rates for local traffic. The court did not address the Commission's authority to set reciprocal compensation rates for interstate traffic.[619] In sum, the Commission plainly has authority to establish pricing rules for interstate traffic, including ISP-bound traffic, under section 201(b), and that authority was preserved by section 251(i).

4. Additional Costs Standard

231. We now turn to reconsideration of our "additional costs" standard for implementing section 252(d)(2). Before describing our new standard, we briefly review the relevant statutory language and the Commission's implementation of the "additional costs" standard in the *Local Competition First Report and Order*. We then explain the importance of incremental cost in regulated pricing. Next we examine the incremental cost of call termination on modern networks. Finally we describe in detail the "additional costs" standard we adopt in this order.

a. Background

232. Section 252(d)(2)(A) sets forth the standard that state commissions, in arbitrating interconnection dis-

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[618] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000) (*Iowa Utils. II*), *rev'd in part sub nom. Verizon v. FCC*, 535 U.S. 467.

[619] Indeed, as discussed above, the court expressly confirmed the Commission's independent authority to set rates for CMRS traffic pursuant to section 332 and declined to vacate the Commission's pricing rules as they applied in the context of CMRS service. *See supra* para. 214; *Iowa Utils. I*, 120 F.3d at 800 n.21.

putes, should apply in setting the "charges for transport and termination of traffic." That section states that "[f]or the purposes of compliance . . . with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."[620] Section 252(d)(2)(B) provides that the preceding standard "shall not be construed (i) to preclude arrangements that afford the mutual recovery of costs through offsetting of reciprocal obligations, including arrangements that waive mutual recover[y] (such as bill and keep arrangements); or (ii) to authorize the Commission or any State commission to engage in any rate regulation proceedings to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls."[621]

233. In the *Local Competition First Report and Order*, the Commission adopted implementing rules interpreting section 252's pricing standards for interconnection and UNEs (section 252(d)(1)), and for reciprocal compensation (section 252(d)(2)). In setting the pricing methodology for interconnection and UNEs, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, known

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[620] 47 U.S.C. § 252(d)(2)(A).

[621] 47 U.S.C. § 252(d)(2)(B).

as TELRIC.[622] The TELRIC methodology assumes that the relevant increment of output is all current and reasonably projected future demand, (i.e., it is designed to calculate the total cost of building a new, efficient network).[623] The Commission found that TELRIC rates should also include a reasonable allocation of forward-looking common costs, including overhead costs. Thus, TELRIC calculates the long-run average incremental cost of a network element. In setting the pricing methodology for reciprocal compensation, the Commission concluded that the statutory pricing standards for interconnection and UNEs (section 252(d)(1)), and for transport and termination of traffic (section 252(d)(2)), were "sufficiently similar" to permit the use of the same TELRIC methodology for establishing rates under both statutory provisions.[624]

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[622] *Local Competition First Report and Order*, 11 FCC Rcd at 15515, 15844-96, paras. 29, 672-732.

[623] *Local Competition First Report and Order*, 11 FCC Rcd at 15850-57, paras. 690-703, *see also* 47 C.F.R. § 51.505.

[624] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054. In applying the TELRIC methodology to reciprocal compensation, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching." For purposes of setting rates, the Commission concluded that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on a usage-sensitive basis constitutes an 'additional cost' to be recovered through termination charges." *Id.* at 16024-25, para. 1057. The Commission excluded non-traffic sensitive costs, such as the costs of local loops and line ports. *Id.* Further, the Commission concluded that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of forward-looking common costs because, the Commission reasoned, a rate equal to incremental costs may not compensate carriers fully when common costs are present. *Id.* at 16025, para. 1058. For transport, the Commission required the call-

234. Market developments since the adoption of the *Local Competition First Report and Order* demonstrate that application of the TELRIC methodology to reciprocal compensation has led to "excessively high reciprocal compensation rates."[625] More specifically, following the Commission's order, certain carriers began designing business plans to take advantage of above-cost reciprocal compensation payments by becoming a net recipient of local traffic. The most prevalent example of regulatory arbitrage for reciprocal compensation is ISP-bound traffic where the Commission found evidence that "CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients" of reciprocal compensation payments.[626] As a result, the Commission has found that reciprocal compensation rates "do not simply compensate the terminating network, but also appear to generate profits for each minute that is terminated, thus creating a potential windfall."[627] In short, the evidence indicates

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ing party's LEC to compensate the called party's LEC for the "additional costs" associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office and for the additional costs of terminating the call to the called party. *Id.* at 16008-58, paras. 1027-118; see also 47 C.F.R. §§ 51.701(c), (d).

[625] *ISP* Remand Order, 16 FCC Rcd at 9185, para. 75); see also Letter from Norina Moy, Director, Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36 (filed Sept. 26, 2008) (Sprint Nextel Sept. 26, 2008 Ex Parte Letter).

[626] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11.

[627] *See, e.g.*, *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11; *see also Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4698 n.67 ("[R]eciprocal compensation rates often substantially exceed the per-minute incremental cost of terminating a

that application of the TELRIC methodology to reciprocal compensation has not led to rates that accurately reflect a carrier's "additional costs" as the Commission initially envisioned and Congress intended. Rather, the Commission's existing pricing standard has led to rates that not only vary significantly among states,[628] but are generally too high, and which ultimately create regulatory arbitrage opportunities. Based on this evidence, and as detailed further below, we therefore conclude that we need to revise the current reciprocal compensation pricing methodology to align our standard more closely with the statutory text and with economic theory to eliminate, as far as possible, opportunities for regulatory arbitrage.

b. The Importance of Incremental Cost In Regulated Pricing

235. To provide a framework for our reconsideration of the proper "additional costs" methodology, we begin with a brief overview of long-standing principles for public utility pricing. As explained below, we believe the traditional economic definition of incremental cost, as ap-

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call and therefore create a potential windfall for carriers that serve customers that primarily or exclusively receive traffic."); *ISP Remand Order*, 16 FCC Rcd at 9192, para. 87 ("[T]here may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination."); BellSouth *ICC NPRM* Comments at 9 ("[R]eciprocal compensation payments enabled carriers to offer services to their customers at rates that bore little relationship to actual costs and provided the recipients of reciprocal compensation an advantage over their competitors."); Verizon *2000 Remand of ISP Declaratory Ruling Public Notice* Comments at 11-12 (noting that competitive LECs with ISP customers reap a "windfall profit" because of high reciprocal compensation rates).

[628] *See, e.g.*, Eastern Rural Telecom Ass'n *ICC FNPRM* Comments at 2-3 ("Depending on the assumptions used to develop a company's TELRIC study, the results can vary significantly and be open to challenge.").

plied to multiproduct firms, is most appropriate for setting intercarrier compensation rates. The Commission's existing TELRIC standard governing reciprocal compensation deviates from this more efficient version of incremental cost, and is likely to lead to rates that significantly exceed efficient levels. We also consider evidence in the record concerning costs of switches and fiber.

236. In economic theory generally and in its application to regulation, the relationship of price and marginal cost is of fundamental importance. Marginal cost can be simply defined as the rate of change in total cost when output changes by an infinitesimal unit. In economics, the term incremental cost refers to a discrete change in total cost when output changes by any non-infinitesimal amount, which might range from a single unit to a large increment representing a firm's entire output.[629] The terms additional costs and avoidable costs are commonly used to refer to incremental costs resulting from an increase or a decrease in output respectively.[630]

237. In a competitive market, it is assumed that both consumers and producers independently will choose outputs to purchase or to supply on the basis of a market

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[629] If $C(q)$ represents the cost of producing an output q and q represents an increment of output, then incremental cost is equal to $C(q + \Delta q) - C(q)$. If incremental cost is used as a guide to pricing, then price should be set equal to the average incremental cost $\frac{C(q + \Delta q) - C(q)}{\Delta q}$. If there are no fixed costs and initial output $q = 0$, then incremental cost pricing is equivalent to average cost pricing. If Δq is small, then incremental cost pricing approximates marginal cost pricing. *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15844, para. 675.

[630] 1 KAHN, THE ECONOMICS OF REGULATION at 65-66. *See also* PRINCIPLES OF PUBLIC UTILITY RATES at 393.

price. In standard economic analysis, this price is determined by the intersection of a downward sloping demand function, which represents consumer valuations for additional units of consumption, and an upward sloping supply function, which represents the marginal cost of supplying an additional unit. The competitive price is efficient in the following sense. At any other price, consumer demands would no longer be equal to producer supply, and market transactions would be limited to the smaller of the two terms.[66] At this level of output, consumers would value an additional unit of output more than the cost of producing it as determined by the marginal cost function. Hence both consumers and producers could be made better off by increasing output by a small amount.[67] When price is equal to the competitive price, no alternative price can be found such that both consumer and producers are better off.

238. *Forward-looking versus Historical Cost*: When prices are determined in a regulated market, similar reasoning applies. In this context, there is a large amount of literature on practical rules and procedures that must be considered to achieve an outcome that is as close as pos-

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[66] If price is greater than the competitive level, consumer demand is less than supply, and demand would determine market volume. If price is less than the competitive level, then producers voluntarily would supply no more than the amount at which marginal cost is equal to price.

[67] Where the market price exceeds marginal cost, there will be an associated deadweight loss in social welfare. The deadweight loss represents the loss in consumer plus producer surplus caused by a deviation from the competitive equilibrium. *See, e.g.*, DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 84 (1990); KENNETH E. TRAIN, OPTIMAL REGULATION 185 (1992) (OPTIMAL REGULATION).

sible to a fully efficient one.[633] The cost of any economic resource is equal to its value in the best alternative use. The cost which a regulated firm incurs in producing a particular output is therefore equal to the value of the economic resources that are used to produce it, and which are therefore no longer available for the production of alternative goods and services. It follows that from the standpoint of economic efficiency, the only costs that are relevant in pricing decisions of a regulated firm are current or future costs, and that historical costs can be ignored.[634] We acknowledge that economists and industry experts have often debated the relative merits of forward-looking (or reproduction) cost versus historical (or original) capital cost in administering rate-of-return regulation,[635] and that regulators, including state regulators and this Commission, have continued to use historical cost in rate setting for smaller, primarily rural telephone companies. Nevertheless, since the adoption of the *Local Competition First Report and Order*, the Commission has consistently concluded that it believes that forward-looking costs are the most appropriate measure of cost.[636] In this order, we reaffirm our conclusion that forward-looking costs should form the basis for

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[633] *See, e.g.*, Ronald. H. Coase, *The Theory of Public Utility Pricing and Its Applications*, 1 BELL J. ECON. 113, 113-128 (1970) (*Theory of Public Utility Pricing*); 1 KAHN, THE ECONOMICS OF REGULATION at 63-86.

[634] *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 122; Alexander C. Larson, *An Economic Guide to Competitive Standards in Telecommunications Regulation*, 1 COMMLAW CONSPECTUS 31, 47 n.100 (1993) (quoting *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 121-22).

[635] *See, e.g.*, 1 KAHN, THE ECONOMICS OF REGULATION at 109-16.

[636] *Local Competition First Report and Order*, 11 FCC Rcd at 15813, 15846, paras. 620, 679.

regulation in a uniform intercarrier compensation regime.

239. *Short-Run versus Long-Run Incremental Cost:* Economists have also debated whether it is appropriate to use short-run or long-run incremental cost as a guide for regulatory pricing.[637] Short-run incremental cost refers to the cost of an increment of demand when some inputs to production are in fixed supply. Long-run incremental cost refers to the cost of an increment when all inputs are variable. In order to set prices so as to maximize economic efficiency at any particular point in time, it is clear that short-run incremental cost is the appropriate concept.[638] For example, if an airline carrier has empty seats for a particular scheduled flight, then it would make sense to sell capacity for those seats at any price that would recover the small additional costs of fuel and amenities for an additional passenger. Pricing based on short-run incremental cost, however, necessarily implies that prices can be adjusted freely and perhaps continuously during the day.[639] Moreover, in a regulatory context, such flexibility is likely infeasible.

240. Short- or intermediate-run costs might also be advocated on practical grounds, since some productive inputs (e.g., poles and conduits) can have extremely long lives. Nevertheless, regulators have traditionally relied on long-run incremental costs rather than short-run incremental costs in setting regulated prices. First, setting

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[637] *See* 1 KAHN, THE ECONOMICS OF REGULATION at 70-75, 83-103; *see also* PHILLIPS, THE ECONOMICS OF REGULATION at 390-91 (rev. ed. 1969); PRINCIPLES OF PUBLIC UTILITY RATES at 417-25.

[638] 1 KAHN, THE ECONOMICS OF REGULATION at 71; DANIEL F. SPULBER, REGULATION AND MARKETS 234 (1989) (REGULATION AND MARKETS).

[639] 1 KAHN, THE ECONOMICS OF REGULATION at 84.

prices on the basis of short-run incremental cost may mean that a carrier would not recover its average total cost of investment over the life of the asset.[640] Second, to the extent that forward-looking costs are used, long-run incremental costs are more naturally and easily accommodated, since a forward looking cost study can legitimately assume that all inputs are variable. In the *Local Competition First Report and Order*, the Commission, in adopting its TELRIC methodology, explained that "[t]his 'long run' approach ensures that rates recover not only the operating costs that vary in the short run, but also the fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element."[641] We reaffirm here the Commission's decision in the *Local Competition First Report and Order* that long-run incremental cost rather than short-run incremental cost is the appropriate cost concept.[642]

241. *Peak Load Pricing*: Closely related to the question of short-run versus long-run costing is the issue of peak load pricing. When demand varies systematically by time of day, day of the week, or over longer periods, there may be periods of time when there is significant excess capacity, since productive inputs clearly cannot vary with such frequency. In such cases, economic efficiency might require that prices should vary by time or day or over longer periods even in the long run.[643] For example, many wireless telephone carriers offer free minutes of usage during weekends or evenings. Al-

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[640] 1 KAHN, THE ECONOMICS OF REGULATION at 88.

[641] *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 692.

[642] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054.

[643] 1 KAHN, THE ECONOMICS OF REGULATION at 89.

though these arguments are indisputable, it has proven difficult in practice to incorporate peak load pricing principles into regulated rate proceedings.[644] Accordingly, we conclude, as the Commission did in the *Local Competition First Report and Order*, that we should not require peak-load pricing as part of an intercarrier compensation regime, although we affirm that carriers should be free to voluntarily negotiate agreements including peak pricing principles.

242. *Common Costs*: Telecommunications carriers are multiproduct firms which provide a large array of services to different groups of consumers. Within the category of traditional telephony, these services include call origination, call termination, local transport, and either access to long distance transport or long distance service through an affiliated carrier. As networks evolve, the number of services that a telecommunications network can provide is rapidly expanding to include Internet access and other data services and, in some cases, video distribution. Many of these services share common facilities.[645] For example, a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services. The incremental cost of voice service, assuming that DSL is already provided, therefore does not include any of the long run incre-

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[644] *See Local Competition First Report and Order* at 15878, paras. 755-57. *See also* 1 KAHN, THE ECONOMICS OF REGULATION at 91-93.

[645] *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676 ("The term 'common costs' refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers).").

mental cost of the loop itself. Similarly, the incremental cost of DSL, assuming voice is already provided, includes only that portion of the loop cost that may be required to condition the loop to meet the higher quality standards that may be required for data transmission.

243. *Methodology for Computing Incremental Cost in Multiproduct Firms*: Common cost and its relationship to incremental cost in multiproduct firms can be more precisely defined as follows using an analysis developed by Faulhaber, Baumol, and others.[646] Under this approach, one imagines a multiproduct firm in which a forward looking cost function is known, which allows one to compute the "stand alone cost" of any possible subset of products. For example, if the set of products is indexed by the set $N = \{1, \ldots, n\}$, then the stand alone cost of the entire firm can be represented by the value $C(N)$. The incremental cost of any individual product j contained in N can then be represented by the value $IC(j) = C(N) - C(N - j)$, where $C(N - j)$ represents the stand alone cost of producing every product in the set N except product j. Under this definition, the incremental cost may be viewed as the *additional costs* of adding product j to a firm currently producing products $(N - j)$. Alternatively, it may be viewed as the cost that may be *avoided* if the firm, currently producing products 1

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[646] *See, e.g.*, Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966, 966-77 (1975). Faulhaber's objective in the paper was to define a test for cross subsidy, which could precisely define the maximum and minimum prices that a regulated firm should be allowed to charge to any subset of customers; WILLIAM J. BAUMOL ET AL., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 351-56 (1982); William J. Baumol, *Minimum and Maximum Pricing Principles for Residual Regulation, in Current Issues in* PUBLIC UTILITY ECONOMICS (A. Danielson & D. Kamerschen eds., 1983).

through n, decides not to produce product j. The common cost for the firm as a whole is then equal to $C(N) - \sum_{j \in N} IC(j)$. When there is significant sharing of facilities used in providing groups of services to customers, common costs are typically positive, and may be a significant portion of the firm's total cost.

244. *Multiproduct Incremental Cost versus TELRIC*: In the *Local Competition First Report and Order*, the Commission adopted a pricing methodology, which it called Total Element Long Run Incremental Cost or TELRIC. Under the TELRIC methodology, prices for UNEs and interconnection would be determined by estimating the forward-looking cost of individual network elements, which the Commission defined as "physical facilities of the network, together with the features, functions, and capabilities associated with those facilities."[647] In adopting the TELRIC methodology, the Commission determined that forward-looking costs should be "based on the least cost, most efficient network . . . technology," assuming current wire center locations.[648] It further determined that the relevant increment should "be the entire quantity of the network element provided."[649] The Commission concluded that "forward-looking common costs shall be allocated among elements and services in a reasonable manner . . . ."[650] In choosing to estimate the

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[647] *Local Competition First Report and Order*, 11 FCC Rcd at 15631, para. 258.

[648] *Local Competition First Report and Order*, 11 FCC Rcd at 15848-49, paras. 683-85.

[649] *Local Competition First Report and Order*, 11 FCC Rcd at 15850, para. 690.

[650] *Local Competition First Report and Order*, 11 FCC Rcd at 15852-53, para. 696.

forward-looking cost of the entire network element, the Commission acknowledged that, when a requesting carrier leased access to that element, it would have exclusive control over that element.[651]

245. With respect to reciprocal compensation, the Commission determined that "the 'additional cost' of terminating a call . . . primarily consists of the traffic-sensitive component of local switching."[652] Nevertheless, the only non traffic-sensitive cost of the local switch that the Commission required states to exclude was the cost of line ports.[653] Similarly, in the rules that the Commission adopted regarding "shared transmission facilities between tandem switches and end offices," the Commission allowed the full forward-looking cost of those facilities to be recovered through usage sensitive charges.[654] Thus, with the exception of requiring recovery of the cost of line ports through flat-rated charges, the Commission's TELRIC rules permitted the full forward-looking cost of the local switch, tandem switch, and shared interoffice transmission facilities, including a reasonable allocation of common costs, to be recovered through usage-based charges. In effect, the Commission's TELRIC methodology permitted average-cost pricing using a forward-looking cost methodology. .

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[651] *Local Competition First Report and Order*, 11 FCC Rcd at 15693, para. 385.

[652] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[653] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057. *Cf.* 47 U.S.C. § 51.509(b) (requiring only that line port costs of the unbundled local switching element be recovered through a flat-rated charge).

[654] 47 U.S.C. § 51.509(d).

246. The TELRIC methodology thus differs significantly from the definition of incremental cost for multi-product firms proposed by Faulhaber and others. First, unlike TELRIC, the traditional economic approach for determining the incremental cost of a single service excludes all common costs. Second, although the TELRIC methodology is essentially an average cost methodology, the traditional economic approach focuses on identifying the additional forward-looking cost that a network would incur if it provided an additional service—in this case call termination. Under the traditional economic definition, the incremental cost of call termination would be determined by estimating the stand alone cost of a network which incorporates all existing services except call termination (including call origination, switching, etc.) and then subtracting this amount from a comparable estimate of the total cost of providing all the same existing services, including call termination. As should be obvious, the incremental cost of call termination under the traditional economic definition should be significantly lower than that calculated under a TELRIC methodology.

247. *The Relevance of Multi-part Pricing*: One common criticism of incremental cost pricing is that it may not permit a firm to recover its total costs, particularly if there are significant common costs.[655] Economists have pointed out, however, that multi-part pricing regimes can potentially lead to more efficient outcomes than uniform prices set equal to either marginal cost or average cost.[656] For example, if the firm is able to charge a fixed monthly fee and a variable usage charge, then it is possible for the firm to set the usage charge at or close to marginal cost

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[655] *See, e.g.*, REGULATION AND MARKETS at 122-23.

[656] *See, e.g., Theory of Public Utility Pricing*, 1 BELL J. ECON. at 117-20; OPTIMAL REGULATION at 191-213.

and recover any residual costs through the fixed charge. In this case, the regulator must take account of both subscription and usage elasticities in order to minimize the possibility that higher fixed fees will cause some subscribers to drop off the network.[657] We note that, in the access charge regime, the Commission recognized the efficiencies associated with multi-part pricing, even if it failed to reduce usage-based charges to marginal or incremental cost.

c. The Incremental Cost of Call Termination on Modern Networks

248. We now consider the evidence in the record concerning the incremental cost of terminating calls on modern telecommunications networks. We note at the outset that there appear to be no cost studies or analyses in the record that attempt to estimate the termination costs using Faulhaber's definition of incremental cost. Thus, we would expect the cost estimates in the record to be significantly lower if they had been calculated using Faulhaber's definition.

249. We consider first evidence concerning the cost of termination on modern circuit switches. We note that, in 1996, when the Commission adopted the TELRIC methodology, circuit switches and fiber optic transmission facilities were generally considered the "least-cost, most

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[657] Demand for subscription is generally estimated to be significantly less elastic than demand for usage. *See* Mercatus Center Sept. 22, 2008 *Ex Parte* Letter at 3 n.15; Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 39 (1999) (estimating elasticity of demand for subscription to be -.005, whereas elasticity of demand for long-distance service is closer to -0.7); *Effects of Breakup of AT&T*, 83 AM. ECON. REV. at 182 (estimating elasticity of demand for basic access at -0.005 and elasticity of demand for long-distance[ ] service between -0.25 and -1.2).

efficient" currently available technology. And it appears that state commissions in interconnection arbitrations analyzed the forward-looking costs of circuit switches and fiber optic transmission facilities in developing TELRIC rates. Sprint Nextel filed an *ex parte* in which it analyzed state UNE rates for unbundled switching and common transport.[658] Sprint Nextel reports that the national weighted average price per minute for unbundled local switching was $0.00058 (with individual rates ranging from a low of $0.00004 to a high of $0.0061). Similarly the national weighted average price per minute for common transport was $0.00057 (with individual rates ranging from a low of $0.00010 to a high of $0.00727). Sprint Nextel further observes that "the rates for companies in the survey with a relatively small number of lines were often lower than the rates for companies with a large number of lines, indicating scale and scope economies do not significantly affect the cost of traffic termination."[659] As Sprint Nextel notes, these rates are all based on the TELRIC methodology and thus represent estimates of average, traffic-sensitive forwarding-looking costs, plus an allocation of common cost and overheads.[660] These estimates, by definition, will significantly exceed incre-

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[658] *See* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter. The data used in the analysis were obtained from the March 2006 "Survey of Unbundled Network Element Prices in the United States."

[659] Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter, Attach. at 3-4.

[660] We note that NuVox disputes some of Sprint Nextel's assumptions. *See, e.g.*, Letter from Brad Mutschelknaus & John J. Heitmann, Counsel to NuVox, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 and WC Docket No. 04-36 (filed Oct. 27, 2008) (NuVox Oct. 27 *Ex Parte* Letter). There is insufficient information in the two *ex parte* submissions for us to resolve this dispute. Carriers remain free to raise issues for consideration in the course of state proceedings.

mental cost estimates using the Faulhaber definition; therefore they provide an upper bound on the rates that may result under a Faulhaber approach to incremental cost.

250. Some additional evidence concerning the incremental cost of terminating calls on modern circuit switches can be gleaned from a declaration filed by three economists in support of the Intercarrier Compensation Forum (ICF) plan.[661] The economists contend that modern circuit switches are to a large extent non-traffic sensitive.[662] According to the authors, whereas earlier generations of switching technologies had large shared resources that could be commandeered by any line needing to place or receive a telephone call, most of the resources in a digital switch are dedicated to individual lines through line ports and trunk ports.[663] In addition, according to the authors, because of the "massive increases in computing power offered by modern microchips," modern circuit switches include "call processing capacity . . . [that] is adequate to serve all reasonably offered demand."[664] In other words, modern switches are designed to be non-blocking, which would suggest that the incremental cost of termination is zero. The declaration thus concludes that the incremental cost of call termination on modern circuit switches should be de minimis.

251. The economists' declaration further argues that the incremental costs of adding additional fiber optic

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[661] Richard N. Clarke et al., *Economic Benefits from Reform of Intercarrier Compensation (ICF Economists), attached to* ICF *ICC FNPRM* Reply, Errata, App. A.

[662] *ICF Economists* at 22.

[663] *ICF Economists* at 20-21.

[664] *ICF Economists* at 21.

transmission capacity similarly are low. They contend that fiber optic technologies have large fixed costs associated with supporting structures (poles, trenches and conduits) and relatively low incremental costs of increasing the capacity of each fiber cable by installing improved laser transmission equipment (which in many cases is based on technological advances made subsequent to the initial fiber deployment). For these reasons, they conclude that "once a fiber cable has been laid on a route, the costs of increasing its transmission capacity are relatively small, so extra minutes of demand result in very little incremental costs. We note that this analysis suggests, at a minimum, that the incremental cost of adding capacity is significantly less—and likely orders of magnitude less—than the forward looking average cost of capacity, as estimated under TELRIC.

252. AT&T submitted evidence that attempts to estimate the incremental cost of a modern softswitch.[665] AT&T maintains that, to estimate the incremental cost of a softswitch, it is necessary to estimate two parameters: the total investment associated with a softswitch, and the percentage of this investment that is traffic-sensitive.[666] Using what it claims are "conservative" estimates, AT&T first compares the estimated investment cost per line of a Class 5 circuit switch with the estimated investment cost per line of a modern softswitch and finds that the investment cost per-line of a softswitch is significantly lower.[667] Although it estimates that the investment cost of a Class

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[665] Letter from Henry Hultquist, Vice President—Regulatory Affairs, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 05-337, 96-45, 99-68, 07-135 (filed Oct. 4, 2008) (AT&T Oct. 4, 2008 *Ex Parte* Letter).

[666] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2.

[667] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3.

5 switch is approximately $100 per line, it finds that the likely investment cost of a softswitch is between $34 and $80 per line.[668] AT&T then considers the likely percentage of the investment costs per line that are traffic-sensitive, and concludes that, depending on the particular softswitch, the traffic-sensitive costs are likely to be between zero and 20 percent of the total investment cost of the switch.[669] Using the higher estimate of 20 percent traffic-sensitive costs, and assuming that each line carries an average of 1400 minutes a month, AT&T derives a traffic sensitive incremental cost per minute of between $0.00010 and $0.00024.[670] For the other softswitch that AT&T considers, however, the traffic-sensitive incremental costs of termination would be zero. Although we do not necessarily accept the precise estimates contained in AT&T's *ex parte* letter, we note that its analysis suggests that the incremental traffic-sensitive costs of modern softswitches are likely to be significantly lower than those of circuit switches and possibly zero, both because the investment cost per line is lower and because the percentage of traffic sensitive costs to total costs is lower for modern softswitches.

253. Windstream Communications, Inc. and NuVox subsequently filed ex parte letters criticizing AT&T's analysis of the traffic sensitive costs of a softswitch,[671] and

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[668] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2-3.

[669] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3-4.

[670] AT&T Oct. 4, 2008 *Ex Parte* Letter at 4.

[671] Letter from Eric N. Einhorn, Vice President, Federal Government Affairs, Windstream Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 06-122, 07-135, 08-152 (filed Oct. 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter); Letter from John J. Heitmann, Counsel for NuVox, to Marlene H. Dortch, Secretary, FCC, CC

AT&T filed a response.[672] Essentially, both Windstream and NuVox criticize specific elements of AT&T's analysis. In addition, Windstream argues that it would be grossly inefficient for a rural carrier to immediately replace circuit switching equipment with softswitch technology, while NuVox contends that even a forward-looking network design would not consist entirely of soft switches. Significantly, NuVox criticizes AT&T for failing to apply the TELRIC methodology, and NuVox recalculates AT&T's estimates using TELRIC. Because we expressly reject use of the TELRIC methodology for purposes of setting reciprocal compensation rates, we conclude that many of the NuVox challenges are moot. To the extent that NuVox and Windstream are challenging cost assumptions that may be applied by states pursuant to our new additional costs methodology, such issues may be raised for consideration by the state commission during the cost proceeding to establish the uniform reciprocal compensation rate. We feel compelled, however, to point out a few of the most critical mistakes and misconceptions contained in the Windstream and NuVox ex parte letters.

254. First, Windstream argues that it is somehow inappropriate to consider the additional costs of softswitches in setting termination rates because it would be economically infeasible for an incumbent LEC to replace

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Docket No. 01-92 (filed Oct. 24, 2008) (NuVox Oct. 24, 2008 *Ex Parte* Letter).

[672] *See* Letter from Henry Hultquist, Vice President Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 07-135 (Oct. 28, 2008) (AT&T's response appears specific to the NuVox Oct. 24, 2008 *Ex Parte* Letter).

all its existing circuit switches with softswitches.[673] This argument fundamentally misconstrues the purpose of a forward-looking cost methodology. The adoption of a forward-looking cost standard does not imply in any way that existing carriers should replace fully functional plant and equipment simply because a more recent vintage of replacement equipment is available. Forward-looking costs are simply a measure of the economic value of future investments, and in a competitive marketplace, these values should determine the appropriate investment decisions regarding replacement of existing plant. More importantly, these values should be used as an appropriate guide in setting efficient prices for the utilization of existing plant and equipment. Second, although both Windstream and NuVox raise objections to AT&T's cost analysis, neither they nor AT&T actually attempt to estimate the incremental cost of call termination. For example, both Windstream and NuVox argue that AT&T's estimates of the cost of investment in forward-looking softswitch technologies are flawed because of the assumptions made about the number of lines served per switch.[674] Although this is may be a valid issue, as it relates to the extent to which softswitch technologies are scalable for deployment in wire centers with different numbers of final customers, the dispute does not really address the issue of the incremental cost of call termination. Third, NuVox claims that the absence of line cards in softswitches is evidence that all switch costs are traffic sensitive.[675] This analysis ignores the potentially large fixed costs associated with a softswitch that are not re-

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[673] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2.

[674] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2-3; NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 8-9.

[675] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 14-15.

lated to line ports. Since softswitches resemble small computers, the appropriate analogy for estimating incremental cost would be the cost of additional memory cards, which could be inserted into the CPU. Fourth, NuVox maintains that both common costs to the firm as a whole and land and building costs associated with switching equipment should be included in any traffic sensitive cost computed for purposes of reciprocal compensation.[676] As explained above, we conclude that common costs should no longer be included in calculating the incremental cost of call termination.

255. Another approach to estimating the incremental cost of call termination is to examine the technology of next generation networks in which voice calls are carried on the same network platform as data and video services delivered to the same customer. Telecommunications carriers are currently deploying such networks at a rapid pace, although the transition to the new technology is far from complete. Nevertheless, most experts believe that IP technologies will be used to deliver the predominant share of voice and data traffic within a few years. Packet technologies, and the resulting commingling of voice and data traffic, make possible a dramatic reduction in the cost of originating and terminating voice traffic in the network. In addition, although the costs of circuit based switching technologies are difficult to quantify using public data sources, the Internet itself provides a variety of sources which can be used to provide at least a rough estimate of the costs associated with a next generation network.

256. Consider the case of a single customer who subscribes to a next generation network offering a full range

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[676] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 18 & n.40.

of voice, video and data services. Suppose that this customer makes exactly one voice call lasting five minutes during each hour of the busy period (which we will unrealistically assume to last for 16 hours every day of the month). High quality (ISDN level) voice service requires a channel capacity of 64 kbps. Ignoring the possibility of signal compression, and making a conservative allowance for packet header overhead,[677] we assume that the single call per hour requires a network capacity of 100 kbps. This capacity requirement translates to 12,800 bytes per second, or 0.0000128 Gigabytes to be available for the duration of the call.[678] Publicly available estimates of the cost of serving residential customers on a broadband network range from $0.1 Gigabytes per month to $0.5 Gigabytes per month.[679] These estimates include the cost of the servers, routers and fiber links necessary to provide service to the residential customer, but do not in-

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[677] *See, e.g.*, VoIP-Info.org, Bandwidth Consumption, http://www.voip-info.org/wiki-Bandwidth+consumption (last visited Oct. 25, 2008); Westbay, Voice over IP Bandwidth, http://www.erlang.com/bandwidth.html (last visited Oct. 24, 2008) (investigating bandwidth requirements for the transmission of voice over an IP based network).

[678] In this analysis, we ignore the additional economies that can result because multiple packet streams for voice traffic can be transmitted simultaneously over the same channel capacity.

[679] The lower estimate is contained in the Wikipedia entry "Broadband Internet Access," http://en.wikipedia.org/wiki/Broadband_Internet_access (last visited Oct. 11, 2008). The higher estimate is contained the trade publication Telephony Online, "OFC: BellSouth Chief Architect warns of HD VOD costs," March 7, 2006, http://telephonyonline.com/iptv/news/BellSouth_VOD_costs_030706 (last visited Oct. 11, 2008). Both estimates are also reported in David Clark, A Simple Cost Model for Broadband Access: What Will Video Cost?, Presentation at the Telecommunications Policy Research Conference (Sept. 28, 2008), *available at* http://tprcweb.com/files/Cost%20analysis%20TPRC.pdf.

clude the substantial cost of the local broadband loop.[680] The hypothetical consumer described above places a demand of 0.000512 Gigabytes per month, and using the upper limit on the estimated cost, we estimate a monthly incremental cost to the consumer of delivering this level of voice service at 0.0256 *cents* per month.[681] Under these conservative assumptions the cost, on a per-minute basis, would be 0.00001 *cents* per minute.[682] Even if the cost estimates used above are wrong by several orders of magnitude, it is clear that the cost of voice traffic on a broadband network is vanishingly small.[683] Although we are

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[680] The cost of the local loop is clearly a common cost that is shared by all of the voice, video, and data services consumed by the subscriber and should not be included under any reasonable definition of incremental cost.

[681] Broadband Internet service is typically priced on the basis of capacity—either the maximum instantaneous upload and download speed or, as in this example, total monthly traffic. A rigorous application of true incremental cost pricing would require measuring each customer's contribution to system costs, which primarily consists of the delays or packet losses imposed on other users. For this purpose, minutes of use are largely irrelevant.

[682] These estimated costs do not include the costs of billing, advertising, or other customer care expenses. As with the case of the local loop, we believe that such costs should not be included in any measure of long run incremental cost of call termination.

[683] It is very unlikely that the cost estimates are significantly low. Telecommunications carriers continue to upgrade their networks to provide precisely the range of video and data services that the articles in a previous footnote were concerned with. Indeed, the BellSouth estimate was given with concern that such services would not be viable unless that estimate of cost could be reduced in the near future. Very similar arguments were made exactly 20 years ago in ROBERT M. PEPPER, THROUGH THE LOOKING GLASS: INTEGRATED BROADBAND NETWORKS, REGULATORY POLICY, AND INSTITUTIONAL CHANGE (FCC, OPP WORKING PAPER No. 24, Nov. 1988), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp24.pdf.

not directing the states to consider the incremental cost of terminating voice telecommunications on such next generation networks,[684] we find that, as carriers move to an all IP broadband world, the incremental costs of terminating voice calls should drop dramatically.

d. Reconsideration of Additional Costs Standard

257. We adopt a new "additional costs" methodology using the traditional economic definition of the incremental cost of a service produced by a multiproduct firm, rather than continuing to rely on the TELRIC methodology.[685] The Supreme Court has made clear that an "'initial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis,' for example in response to changed factual circumstance, or a change in administrations."[686] Consistent with this, the Commission, in its 2005 *Intercarrier Compensation FNPRM*, solicited comment on whether the Commission should reinterpret "additional costs" to mean "incremental cost" in light of the need to reform

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[684] *See infra* section V.C.1.

[685] We find it preferable to shift entirely to an approach based on the traditional economic definition of incremental cost, rather than trying to achieve the same result through extensive revisions to the TELRIC methodology as some commenters suggest. *See, e.g.*, Rural Alliance *ICC FNPRM* Comments at 50-54 (calling for a more precise definition of TELRIC for purposes of reciprocal compensation).

[686] *Brand X*, 545 U.S. at 981 (quoting *Chevron U.S.A. Inc. v. Nat'l Res. Def. Council* (*Chevron*), 467 U.S. 837, 863-64 (1984) and citing *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Automobile Ins. Co.* (*State Farm*), 463 U.S. 29, 59 (1983) (Rehnquist, J., concurring in part and dissenting in part)).

intercarrier compensation due to market distortions.[687] In response, several commenters supported such a proposal noting that the additional incremental cost of terminating traffic is de minimis.[688] Based on the evidence highlighted above and for the reasons set forth below, we revise our interpretation of the "additional costs" language in section 252(d)(2) to mean "incremental costs" as traditionally defined. We believe that this conclusion is supported by the economic theory discussed above, and represents a more appropriate interpretation of the "additional costs" standard than the TELRIC methodology.[689]

258. As an initial matter, the Commission plainly has the authority to revise its interpretation of "additional costs."[690] Indeed, the Supreme Court has recognized that

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[687] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4719, para. 71.

[688] *See, e.g.*, CTIA *ICC FNPRM* Comments at 16 ("Because a call does not impose significant incremental costs on either the calling party's or called party's network, there is no justification for allowing the terminating network to impose any charge on the non-terminating network."); Frontier *ICC FNPRM* Comments at 7 ("However, there is virtually NO additional incremental cost of sending a minute-of-use across [dedicated hardware interfaces]."); Western Wireless *ICC FNPRM* Comments at 16 ("Independent Wireless Carriers urge the Commission to confine its analysis of 'additional cost' only to the incremental traffic-sensitive switching and transport costs actually incurred by the parties exchanging traffic for purposes of intercarrier compensation.").

[689] We reaffirm that the TELRIC methodology is appropriate for setting interconnection and network element rates pursuant to section 252(d)(1), where Congress directed the Commission to consider a "reasonable profit."

[690] The Supreme Court affirmed the Commission's authority to apply a cost methodology for the states to implement. *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. *See also id.* at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the

the phrase "additional costs" is ambiguous.[691] Words like additional cost "give ratesetting commissions broad methodological leeway,"[692] and courts owe "substantial deference to the interpretation the Commission accords them."[693] The Commission, consistent with its obligation to "consider varying interpretations and the wisdom of its policy on a continuing basis" now revises its definition of "additional costs."[694]

259. Revising our interpretation of "additional costs" to follow the traditional economic definition of the incremental cost of a service is supported by the Commission's interpretation of the term "additional costs" in section 224 of the Act. Section 224, which addresses the pricing of pole attachments, is the only other place in the Act that uses the term "additional costs." The Commission consistently has found that the term "additional costs" in

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regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has."); 47 U.S.C. § 201(b); *United Telegraph Workers, AFL-CIO v. FCC*, 436 F.2d 920, 923 (D.C. Cir. 1970) (citations and quotations omitted) (finding that section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act").

[691] *See Verizon v. FCC*, 535 U.S. at 499-501 ("[W]ithout any better indication of meaning than the unadorned term, the word 'cost' in section 252(d)(1), as in accounting generally, is 'a chameleon,' a 'virtually meaningless' term . . . .") (citations omitted).

[692] *See Verizon v. FCC*, 535 U.S. at 499-501 (quoting *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 423 (Breyer, J., concurring in part and dissenting in part)).

[693] *Capital Network System, Inc. v. FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994).

[694] *Brand X*, 545 U.S. at 981 (quoting *Chevron*, 467 U.S. at 863-64 and citing *State Farm*, 463 U.S. at 59 (Rehnquist, J., concurring in part and dissenting in part)).

section 224 means incremental cost,[695] and that the legislative history for section 224 makes clear that Congress intended such a result.[696] Interpreting the term "additional costs" as used in two parts of the Act in the same manner is consistent with the "presumption that identical words used in different parts of the same act are intended to have the same meaning."[697]

260. In contrast, the statutory pricing standard for reciprocal compensation ("additional costs") is not the same as the statutory pricing standard for UNEs ("cost" plus "a reasonable profit").[698] Even though the two statutory provisions may, as the Commission found previously, be "similar," our subsequent experience indicates that TELRIC is not consistent with the "additional costs" standard. First, as discussed above, evidence indicates that reciprocal compensation rates based on TELRIC methodology were "excessive."[699] If reciprocal compensa-

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[695] *See, e.g., Adoption Of Rules For The Regulation Of Cable Television Pole Attachments*, CC Docket No. 78-144, Memorandum and Opinion and Second Report and Order, 72 FCC 2d 59, 62, para. 8 (1979); *Adoption Of Rules For The Regulation Of Cable Television Pole Attachments*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d 3, 15, App. (1978) (*Cable Television Pole Attachment NPRM*).

[696] *Cable Television Pole Attachment NPRM*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d at 15, App. ("'Additional costs' are generally equivalent to what is referred to as incremental cost, and the proportional part of 'Operating expenses and actual capital costs' are generally equivalent to fully allocated costs." (quoting S. REP. NO. 95-580 at 19-21 (1977)).

[697] *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

[698] *Compare* 47 U.S.C. § 252(d)(1) *with* 47 U.S.C. § 252(d)(2).

[699] *See, e.g., Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4694, 4697-98, 4717, 4719, paras. 16, 23-24, 66, 71-72; *Intercarrier*

tion rates truly reflected the incremental "additional costs," regulatory arbitrage should not occur because a carrier would not make a profit by recovering its incremental cost.[700]

261. Second, TELRIC includes the cost of the "total element" and, as a result, measures the long run incremental average cost of the switch including common costs and overhead, not just the additional costs of using the function to terminate another carrier's traffic. In other words, TELRIC measures the *average* cost of providing a function, which is not necessarily the same as the *additional* costs of providing that function. Because of this, we expect that the TELRIC methodology would continue to produce reciprocal compensation rates above the true

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Compensation NPRM, 16 FCC Rcd at 9616-18, paras. 11-18; *ISP Remand Order*, 16 FCC Rcd at 9161-62, paras. 18-20.

[700] For the same reasons, we reject suggestions that TELRIC should be used to set a unified rate for intercarrier compensation. *See, e.g.*, Ohio PUC *ICC FNPRM* Comments at 20 ("[T]he Ohio Commission recommends the use of the TELRIC standard for setting intercarrier compensation rates."); Pac West et al. *ICC FNPRM* Comments at 9 ("The 'additional cost' standard should continue to be tied to TELRIC"); Time Warner Telecom et al. *ICC FNPRM* Comments at 1-2 ("[A] central component of reform must be the requirement that, to the extent possible, each carrier charge a single, cost-based rate for the exchange of all types of traffic. . . . [T]he Commission arguably has the authority to mandate that states use a cost-based methodology, in particular TELRIC, as the basis for setting all intercarrier termination rates."); Integra *ICC FNPRM* Comments at 3 ("Integra urges the Commission to . . . [u]nify access and reciprocal compensation rates at TELRIC based levels on a company-by-company basis."); KMC and Xspedius *ICC FNPRM* Reply at 3 ("[T]he Commission should support tariffed-based intercarrier compensation arrangements that: (i) set rates no higher than the comparable TELRIC (or similar cost-based) rates."); XO *ICC FNPRM* Reply at 11 ("[T]he only appropriate intercarrier compensation regime must include TELRIC-based rates.").

"additional costs" of terminating such traffic, in light of evidence that the cost of terminating traffic today is low[701] and is decreasing even further as carriers transition to softswitches[702] and ultimately pure packet switches. Consistent with our change in methodology, we also disavow our finding in the *Local Competition First Report and Order* that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on a usage-sensitive basis constitutes an "additional costs" to be recovered through termination charges."[703] In particular, as explained above, we specifically exclude common costs and overhead allocations from the calculation of what constitutes "additional costs" under our new pricing methodology.

262. We thus end our reliance on the TELRIC methodology for setting reciprocal compensation rates, and instead require that such rates be set pursuant to our new incremental cost methodology.[704] In our Implemen-

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[701] The national average of TELRIC rates for transport and termination of calls was $0.00212 in 2004, which likely overstates the actual incremental costs because, as noted above, TELRIC includes common and overhead costs and examines the average cost of the function, not the additional cost of terminating traffic. Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Sept. 2, 2004) (CBICC Sept. 9 *Ex Parte* Letter); *see also* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter.

[702] *See* T-Mobile *ICC FNPRM* Comments at 29-30.

[703] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[704] A number of parties advocate for or against Commission adoption of bill-and-keep for intercarrier compensation. *See, e.g.*, Letter from Jonathan Askin, Counsel for FeatureGroup IP, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3-4 (filed Oct. 7, 2008); Letter from Paul W. Garnett, Assistant Vice President of Regulatory Affairs, CTIA, to Marlene H. Dortch, Secretary, FCC,

tation section below, we provide specific guidance to the states regarding how to apply this new methodology. We note that this Commission takes seriously its responsibility to ensure that rates for carriers are just, reasonable, and not confiscatory. In this order, we have set in motion mechanisms to help ensure that the financial viability of carriers will not be undermined. We feel confident that

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CC Docket No. 01-92 at 1 (filed Oct. 7, 2008); Corr *ICC FNPRM* Comments at 8; Cox *ICC FNPRM* Comments at 8-9; ICF *ICC FNPRM* Comments at 26, 30; Western Wireless et al. *ICC FNPRM* Comments at 6-8. *But see, e.g.*, Letter from Tamar E. Finn, Counsel for PAETEC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 10 (filed Oct. 7, 2008) ("Mandatory Bill-and-Keep Is Not A Viable or Fair Solution"); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Cavalier Telephone et al, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 3, 2008) ("[T]he adoption of mandatory bill-and-keep arrangements is extremely ill advised as a policy matter."); BellSouth *ICC FNPRM* Comments at 9 ("[A] plan to transition rates ultimately to bill-and-keep would not promote economic efficiency or preserve universal service, nor is bill-and-keep competitively neutral."); CCG Consulting Inc. (CCG) *ICC FNPRM* Comments at 7 ("[A]ccess rates should not be reduced to zero through implementation of a Bill and Keep mechanism."); CenturyTel *ICC FNPRM* Comments at 4 (". . . CenturyTel unequivocally opposes replacing intercarrier compensation with a "bill and keep" regime."); CCAP *ICC FNPRM* Comments at 11 ("The CCAP urges the Commission to avoid implementation of a bill and keep regime . . . ."); Frontier *ICC FNPRM* Comments at 6 (arguing that bill and keep is inappropriate because it does not account for asymmetric traffic patterns); SBA *ICC FNPRM* Comments at 7 (arguing that bill-and-keep is inappropriate between rural and larger LECs due to various asymmetries). We believe the reforms we adopt here are preferable to a pure bill-and-keep requirement and more appropriately balance the interests of consumers and carriers at this time. The approach we adopt in this order avoids the need to resolve disputes in the record regarding bill-and-keep in various circumstances because it allows parties to advocate for such an approach before state commissions and parties may negotiate such arrangements.

these mechanisms, in combination with the other avenues available for carriers to offset declines in access revenues, will be sufficient to achieve this result.[705]

263. Moreover our decision to adopt a unified intercarrier compensation methodology is in no way arbitrary or adopted with any confiscatory purpose. In fact, the determinations made in this order reveal just the contrary, our decision to raise the cap on SLCs, our referral to the Federal-State Joint Board on Separations (Separations Joint Board) of the issue of whether to allow additional increases in SLC caps in Part V.C below, and our acknowledgment of the ability of a carrier to establish entitlement to supplemental universal service to help en-

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[705] Some carriers have suggested that our changes in ratemaking methodology will necessarily produce confiscatory rates and constitute a taking. *See, e.g.*, NTCA, Interim Universal Service & Intercarrier Compensation Reform Proposal (NTCA Interim Proposal) at 19-22, *attached to* Letter from Daniel Mitchell, Vice President, Legal & Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92 (filed Oct. 6, 2008) (NTCA Oct. 6, 2008 *Ex Parte* Letter) (contending that the Commission's current access regime, not to mention any reductions in access rates, threatens rate-of-return carriers with unconstitutional takings). *See also* Cincinnati Bell *ICC FNPRM* 11-12 ("The elimination of interstate switched access charges without an opportunity to earn the revenue in another fashion could be confiscatory . . . ."); GVNW Consulting *ICC FNPRM* Comments at 9 ("The existing system of cost recovery consisting of three equally important components of access charges, universal service support, and local rates is the only approach available to the Commission that will enable it to avoid valid claims of confiscation."). This argument lacks merit. Faced with a similar challenge to the TELRIC methodology previously adopted by the Commission, the Supreme Court stated unequivocally that "this Court has never considered a taking challenge on a ratesetting methodology without being presented with specific rate orders alleged to be confiscatory . . . ." *Verizon v. FCC*, 535 U.S. at 524 (citations omitted).

sure that carriers can maintain their financial integrity.[706] Although in most cases the rates for intrastate and interstate terminating access will drop substantially, that alone is not the test for whether a taking has occurred; rather, a primary consideration for takings claims is whether the rates ultimately adopted will produce a reasonable return sufficient to enable a company to maintain its financial integrity.[707]

C. Implementation

264. In this section, we detail certain implementation items. First, we provide guidance to states with regard to their implementation responsibilities for the intercarrier compensation regime we adopt today. Importantly, this includes setting reciprocal compensation rates using the new incremental cost pricing methodology. We also provide guidelines for the states' application of the modification and suspension provisions of section 251(f)(2) of the Act. We explain the need to require symmetrical compensation arrangements without any exceptions under section 252(d)(2)(A)(ii) of the Act. And we discuss the effect of our intercarrier compensation reforms on existing interconnection and commercial agreements. Finally, we address the extent to which reduced revenue from carrier-to-carrier charges may be replaced through end-user charges or new universal service support, where needed.

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[706] *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) ("Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return . . . .").

[707] *FPC v. Hope Natural Gas Co.*, 320 U.S. at 605.

1. Direction to the States

265. We set forth the timeline for states to implement our comprehensive reform and adopt an interim, uniform reciprocal compensation rate along with a transition plan in section [III.B.2] above. In this section, we set forth additional parameters for states to follow in implementing the reforms adopted in this order.

a. Setting Final Reciprocal Compensation Rates Based on Incremental Cost

266. Under our new methodology for setting final reciprocal compensation rates, states will need to set prices according to a forward-looking economic cost study or computer cost model using the Faulhaber principles to identify the traffic-sensitive incremental cost of transport and termination of traffic.[768] First, states will need to evaluate a forward-looking economic cost analysis of a stand-alone network that performs all functions of a modern telecommunications network, including transport and termination of other carriers' traffic. Second, states will need to evaluate a forward looking economic cost analysis of a stand-alone network that performs all the same functions except for the transport and termination of other carriers' traffic. Third, states must compare the costs of these two networks. The difference between the costs of the two networks is the additional costs of termination of traffic subject to the "additional costs" standard we adopt in this order.[769]

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[768] We recognize that the incremental cost of terminating traffic may include certain non-traffic-sensitive costs, such as the cost of a trunk port. Consistent with cost-causation principles, however, such non traffic-sensitive costs may not be recovered through per-minute charges, but must rather be recovered through flat-rated monthly charges associated with interconnection trunks.

[769] *See supra* section V.B.4.c.

267. We offer further guidance regarding specific aspects of these cost studies. First, these cost studies must use the least cost, most efficient network technology. We find that the least cost, most efficient switch today is a softswitch.[710] We further find that the least cost, most efficient technology for transport is fiber optic cable.[711] We observe that, when carriers deploy fiber, they typically deploy capacity significantly in excess of current needs.[712]

268. Second, consistent with the traditional economic definition of the incremental cost of a service,[713] the cost studies must exclude all common costs, including overhead costs. Third, all non-traffic-sensitive costs must be excluded from the cost studies.[714] Cost studies using the TELRIC methodology do not meet these requirements, given the differences between TELRIC and the traditional economic methodology for determining the incre-

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[710] *See supra* section V.B.4.c.

[711] *See supra* section V.B.4.c.

[712] *See, e.g., Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156, 20237, para. 186 (1999) (subsequent history and citation omitted) ("As we explained in the *Inputs Further Notice*, in determining appropriate cable sizes, network engineers include a certain amount of spare capacity to accommodate administrative functions, such as testing and repair, and some expected amount of growth."); *Triennial Review Order*, 18 FCC Rcd at 17166, para. 312 n.919 (citing evidence that "the first carrier to lay fiber to a particular location will lay significantly more than it will need because the incremental cost of burying additional fibers is negligible").

[713] *See supra* section V.B.4.c.

[714] We thus go beyond the requirement in the *Local Competition First Report and Order* that only required states to exclude the cost of line ports, *see* 11 FCC Rcd at 16025, para. 1057, and mandate that *all* non-traffic sensitive costs be excluded.

mental cost of a service discussed above.[715] Available evidence suggests that the incremental costs of terminating traffic, as determined using this methodology, are likely to be extremely close to zero.

269. We also require each state to set a single, uniform rate for all carriers in that state through their pricing proceedings. We find this approach warranted for several reasons. First, softswitches are easily scalable, and thus the incremental cost of termination does not vary with the number of lines the switch serves. Second, because carriers tend to deploy significant excess capacity when deploying fiber, the incremental cost of adding traffic is likely to approach, or equal, zero. Third, we find that setting a single uniform rate for all incumbent LECs and interconnecting carriers in a state simplifies the regulatory process, minimizes arbitrage that could arise, and reduces the likelihood that unidentifiable traffic would remain a problem. Finally, setting rates based on the costs of the current, least cost, most efficient technology creates incentives for carriers with less efficient networks to migrate more quickly to those more efficient technologies.

270. Following the transition, once carriers are charging the final uniform reciprocal compensation rate, we establish the following default rules regarding the network "edge."[716] These default rules would not require

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[715] *See, e.g., supra* section V.B.4.c.

[716] *See* Letter from Hank Hultquist, AT&T Services, Inc., and Donna Epps, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 (filed Oct. 14, 2008) (AT&T and Verizon Oct. 14, 2008 *Ex Parte* Letter) (providing seven default rules); Letter from John N. Rose, President, OPASTCO, and Kelly Worthingon, Executive Vice President, WTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, 01-92, WC Docket No. 05-337, Attach. at 2 (filed

changes to physical points of interconnection, but would simply define functions governed by a uniform terminating rate.[717]

- For every call, the calling party service provider (e.g., the calling party's LEC for a local call or the calling party's IXC for a long distance call) is responsible for the transmission and routing of the call to the network edge of the called party service provider.
- The calling party service provider may fulfill its responsibility for the transmission and routing of a call to the called party service provider network edge via its own facilitates and services, the facilities and service of another entity (including the

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Oct. 29, 2008) (Corrected OPASTCO/WTA Oct. 29, 2008 Ex Parte Letter) (discussing a "rural transport rule" for rural rate-of-return incumbent LECs). We reject PAETEC's assertion that the Commission lacked notice to adopt such rules. *See* Letter from Jonathan S. Frankel and Michael A. Romano, Counsel for PAETEC, CC Docket Nos. 99-68, 01-92 at 2-3 (Oct. 28, 2008) (PAETEC Oct. 28, 2008 *Ex Parte* Letter). The Commission expressly sought comment on this issue in the *Intercarrier Compensation FNPRM*. *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4687, 4702-03, 4712-13, 4727-30, paras. 4, 34, 40-44, 54, 91-97.

[717] Thus, the default "edge" rule we adopt today does not alter any obligations of incumbent LECs' to interconnect at any technically feasible point, nor does the rule alter carriers' ability to request interconnection. *See, e.g.*, Letter from Susanne A. Guyer, Verizon, to Chairman Kevin J. Martin, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 05-337, 06-112 at 5 (filed Oct. 5, 2008). *See also, e.g.*, PAETEC Oct. 28, 2008 *Ex Parte* Letter at 5-6 (expressing concern that the adoption of rules regarding a network "edge" not alter existing rules and obligations regarding physical interconnection). Moreover, the "edge" rules we adopt, which will apply at the end of the transition period, are merely a default, and carriers are free to negotiate alternative arrangements.

called party's service provider), or any combination.

- The calling party service provider is also responsible for the payment of the uniform terminating rate to the called party service provider. The called party service provider is responsible for performing all network functions to deliver traffic from the network edge to the called party, including dedicated transport, common transport, tandem switching, end office switching, and SS7 messaging.
- The reciprocal compensation regime of section 251(b)(5) will apply to traffic from the called party service provider network edge to the called party.
- The called party service provider's network edge is the location of its end office, MSC, point of presence, or trunking media gateway, which PSTN routing conventions (e.g., NPAC or LERG) associate with the called party telephone number unless that location subtends a tandem switched owned or controlled by the called party service provider, in which case that tandem is the network edge for that call. A service provider that utilizes a tandem as its edge may require, upon reasonable request consistent with standard industry network interconnection principles, that calling party service providers groom their traffic onto segregated trunk groups.
- The called party service provider must either permit interconnection at its edge for purposes of exchanging traffic with the calling party service provider or provide transport at no charge to that edge from a location in the same LATA where it does permit such interconnection.

- The calling party service provider may at its sole discretion choose whether to interconnect directly or indirectly with the called party service provider.
- Notwithstanding the forgoing, for local and extended area service (EAS) calls made by a rural rate-of-return incumbent LEC's customer to a non-rural carrier's customer, the rural rate-of-return incumbent LEC will be responsible for transport to a non-rural terminating carrier's point of presence (POP) when it is located within the rural rate-of-return incumbent LEC's service area. When the non-rural terminating carrier's POP is located outside the rural rate-of-return incumbent LEC's service area, the rural rate-of-return incumbent LEC's transport and provisioning obligation stops at its meet point and the non-rural terminating carrier is responsible for the remaining transport to its POP.

b. Symmetry

271. We conclude that final uniform reciprocal compensation rates should be symmetrical.[718] In contrast to the approach taken in the *Local Competition First Report and Order*, we require, for the reasons described below, symmetry in all cases once the final uniform reciprocal compensation rates become effective.

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[718] "Symmetrical compensation arrangements are those in which the rate paid by an incumbent LEC to another telecommunications carrier for transport and termination of traffic originated by the incumbent LEC is the same as the rate the incumbent LEC charges to transport and terminate traffic originated by the other telecommunications carrier." *Local Competition First Report and Order*, 11 FCC Rcd at 16031-32, para. 1069.

272. *Background.* In the *Local Competition First Report and Order*, the Commission concluded that charges for reciprocal compensation were to be presumptively symmetrical and that it was "reasonable to adopt the incumbent LEC's transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination."[719] The Commission observed that "[b]oth the incumbent LEC and the interconnecting carriers usually will be providing service in the same geographic area, so the forward-looking economic costs should be similar in most cases."[720] Moreover, by using the incumbent LEC's costs of transport and termination, the Commission found that symmetry would provide an incentive for interconnected carriers to minimize costs because if the interconnected carrier could reduce its costs below the costs of the incumbent LEC, then it could realize additional termina-

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[719] *Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085. The Commission provided the following findings supporting its conclusion: (1) "using the incumbent LEC's forward-looking costs for transport and termination of traffic as a proxy for the costs incurred by interconnected carriers satisfies the requirements of section 252(d)(2)" and "is consistent with section 252(d)(2)(B)(ii)"; (2) "[i]f both parties are incumbent LECs, . . . the larger LEC's forward-looking costs should be used to establish the symmetrical rate for transport and termination"; (3) "larger LECs are generally in a better position to conduct a forward-looking economic cost study"; (4) "imposing symmetrical rates based on the incumbent LEC's additional forward-looking costs will not substantially reduce carriers' incentives to minimize those costs"; and (5) "states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch." *Id.* at 16040-42, paras. 1085-86, 1090.

[720] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085.

tion revenue.[721] Symmetrical compensation also provided the incumbent LECs an incentive to minimize costs. The Commission further found that symmetry reduced incumbent LECs' bargaining strength because asymmetrical rates could have allowed incumbent LECs to negotiate high charges for traffic terminating on their networks and low charges for traffic originating on their networks, citing as an example incumbent LECs' treatment of CMRS providers.[722] A presumption of symmetric rates was administratively efficient and did not require a competing carrier to conduct a forward-looking cost study to enter the market, lowering the cost of entry and thus increasing competition.[723]

273. The Commission, however, carved out an exception to the presumption of symmetry. In the *Local Competition First Report and Order*, the Commission permitted interconnecting carriers to rebut the presumption of symmetry by submitting a forward-looking cost study to show that their costs of termination were higher than the incumbent LEC's.[724] If the interconnecting carrier established that "the costs of efficiently configured and oper-

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[721] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1086 ("A symmetric compensation rule gives the competing carriers correct incentives to minimize its own costs of termination because its termination revenues do not vary directly with changes in its own costs.").

[722] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041, para. 1087 (noting that incumbent LECs have used their greater bargaining power to negotiate asymmetrical rates with CMRS providers and to charge CMRS providers origination, as well as termination, charges).

[723] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041-42, para. 1088.

[724] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

ated systems [were] not symmetrical," the state commission could adopt a "different compensation rate" for the interconnecting carrier.[725]

274. *Discussion.* We now require symmetric rates and conclude that the exception that permitted asymmetric rates under certain circumstances is no longer warranted.[726] We note that there is scant evidence of any competitive LECs seeking to establish their own, higher, costs during the last 12 years, let alone being successful in doing so.[727] We conclude that asymmetric rates could undermine the comprehensive reform we adopt by permitting different termination rates for traffic in the same geographic area, which could open the door for continued regulatory arbitrage and thwart the intended public interest benefits associated with reforming the patchwork of existing intercarrier compensation payments.

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[725] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

[726] We note that the rates that will apply under our transition plan, discussed *supra* Part V.B.2, will not necessarily be symmetric. For example, we do not permit CMRS providers to assess access charges during the transition. *See supra* para. 197; 47 U.S.C. § 251(f)(2). Our symmetry rules thus apply outside the transition framework, i.e., for carriers exchanging traffic at the final, uniform reciprocal compensation rate, or for carriers that have received a suspension or modification of our intercarrier compensation requirements pursuant to 251(f)(2).

[727] Indeed, we are only aware of one case where a competitive LEC attempted to rebut the presumption and, in that case, the state commission found that the competitive LEC had failed to do so. *See* Petition of Sprint Spectrum L.P. d/b/a Sprint PCS, Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Intercarrier Agreement with Verizon New York Inc., Case 01-C-0767, Arbitration Order, 2002 WL 31505732 (N.Y. P.S.C. 2002) (holding that Sprint did not rebut the presumption that its costs were higher than the incumbent LEC's).

275. As noted above, symmetrical rates promote efficiency. Symmetry will encourage interconnecting carriers to deploy more efficient technology to reduce their costs. Notably, the Commission of the European Communities (European Communities) has also found that divergent regulatory treatment between different technology termination rates, as this rebuttable presumption exception allows, creates distortions among markets.[728] In the context of fixed versus mobile telephony, the European Communities recognized that some European countries have allowed smaller CMRS carriers to charge higher termination rates to compensate for these carriers' lack of economies of scale.[729] The European Communities concluded that these higher termination rates for mobile technology led to higher retail rates for customers and lower usage of this technology.[730] As the European experience shows, allowing the present exception to the symmetry rule could encourage higher termination rates, and asymmetric termination rates—particularly if such termination rates were high for one carrier—could reduce consumer welfare and lead to higher prices.

276. We conclude that requiring symmetrical compensation arrangements without any exceptions is proper under section 252(d)(2)(A)(ii) of the Act.[731] We also con-

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[728] *See* THE COMMISSION OF THE EUROPEAN COMMUNITIES, DRAFT COMMISSION RECOMMENDATION ON THE REGULATORY TREATMENT OF FIXED AND MOBILE TERMINATION RATES IN THE EU 3, para. 3 (2008), *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/termination_rates/termination.pdf (last visited Oct. 24, 2008) (EUROPEAN COMMUNITIES).

[729] *See* EUROPEAN COMMUNITIES at 2, para. 2.

[730] *See* EUROPEAN COMMUNITIES at 3, para. 3.

[731] This section requires that, in setting rates under interconnection agreements, states must ensure that reciprocal compensation charges are a "reasonable approximation of the additional costs of

firm that this mandatory symmetry requirement applies without regard to whether traffic exchanged by the interconnected carriers is balanced or not. Given the substantial benefits of symmetrical rates as described above, the likelihood that allowing asymmetrical rates would give carriers an incentive to find ways to arbitrage the higher rates, and the minimal costs associated with terminating calls,[732] we find that an exception to symmetrical rates where traffic is out of balance is not warranted.

c. Modifications and Suspensions under Section 251(f)(2)

277. In light of the importance of bringing uniformity and symmetry to intercarrier compensation, eliminating opportunities for regulatory arbitrage, and providing regulatory certainty to carriers in making investment plans, we find it appropriate to adopt guidelines regarding the application of section 251(f)(2). Section 251(f)(2) of the Act gives state commissions the ability to suspend or modify our intercarrier compensation rules implementing section 251(b) and (c) under certain conditions.

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terminating such calls." *See* 47 U.S.C. § 252(d)(2)(A)(ii). In the *Local Competition First Report and Order*, the Commission found that the incumbent LEC's costs were a reasonable proxy for other carriers' costs. 11 FCC Rcd at 16040, para. 1085. We reaffirm that finding, especially given that our pricing methodology focuses on the costs of the least cost, most efficient network technology. Moreover, per the express terms of the Act, the "additional costs" standard applies only to the costs of the incumbent LEC, not the competitive LEC. This interpretation of the Act promotes efficiency and therefore bolsters competition, consistent with the goals of the Act. *See* 1996 Act, Preamble (declaring the purpose of the Act to be "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").

[732] *See supra* section V.B.4.c.

Specifically, section 251(f)(2) of the Act permits a "local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide" to "petition a State commission for a suspension or modification of the application of a requirement or requirements of [section 251] (b) or (c)."[733] The state commission shall grant such petition "to the extent that, and for such duration as, the State commission determines that such suspension or modification (A) is necessary (i) to avoid a significant adverse economic impact on users of telecommunications services generally; (ii) to avoid imposing a requirement that is unduly economically burdensome; or (iii) to avoid imposing a requirement that is technically infeasible; and (B) is consistent with the public interest, convenience, and necessity."[734] In the *Local Competition First Report and Order*, the Commission "decline[d] . . . to adopt national rules or guidelines" regarding the specific implementation of section 251(f), but explained that the Commission "may offer guidance on these issues at a later date, if we believe it is necessary and appropriate."[735] The Supreme Court subsequently confirmed that the Commission has the authority to interpret section 251(f).[736] The only existing Commission guideline regarding section 251(f)(2) provides that the burden of proof is on the LEC seeking suspension or modification of particular requirements.[737]

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[733] 47 U.S.C. § 251(f)(2).

[734] 47 U.S.C. § 251(f)(2).

[735] *Local Competition First Report and Order*, 11 FCC Rcd at 16118, para. 1263; 47 U.S.C. § 251(f)(2).

[736] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

[737] *See* 47 C.F.R. § 51.405(b). In the *Local Competition First Report and Order*, the Commission held that, in petitions under section 251(f)(2), "a LEC must offer evidence that application of those re-

278. As an initial matter, we conclude that any suspension or modification granted pursuant to section 251(f)(2) must be for a limited "duration" and cannot be indefinite. This interpretation follows directly from the express language of section 251(f)(2). Specifically, section 251(f)(2) provides that the state should grant a suspension or modification "to the extent that, *and for such duration as*, the State commission determines that such suspension or modification"[738] satisfies the statutory test. Congress thus expected that the conditions warranting suspension or modification of a requirement would not be permanent, and it permitted the states to continue such modifications or suspensions only for a particular "duration," rather than remaining in place indefinitely. In contrast, Congress adopted the opposite approach in section 251(f)(1), where it provided a default exemption for "rural telephone companies" from section 251(c) that continues

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quirements would be likely to cause undue economic burdens beyond the economic burdens typically associated with efficient competitive entry." 11 FCC Rcd at 16118, para. 1262. The Commission also placed the burden of proof on the carrier seeking the relief under section 251(f)(2). *Id.* at 16118, para. 1263. Although the Supreme Court ultimately upheld the Commission's authority to interpret section 251(f), *see AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385, the Eighth Circuit subsequently vacated the Commission's interpretation of "undue economic burden," finding that the Act requires a state to look at the entire economic burden not just the additional burden of complying with sections 251(b) or 251(c). *See Iowa Utils. II*, 219 F.3d at 759-62. The Eighth Circuit also found that the Commission erred in placing the burden of proof on the rural LEC when a requesting carrier seeks to remove the section 251(f)(1) exemption from section 251(c). The Eighth Circuit therefore vacated sections 51.405(a), (c), and (d) of our rules, *id.* at 762, but did not disturb the allocation of burden of proof under section 251(f)(2) as set forth in 47 C.F.R. § 51.405(b).

[738] 47 U.S.C. § 251(f)(2) (emphasis added).

indefinitely "until" certain statutory criteria are met.[739] Accordingly, we conclude that the LEC requesting the suspension or modification under section 251(f)(2) has the burden of demonstrating the appropriate duration of any suspension or modification. To the extent that a state grants a suspension or modification for a particular duration, the Commission encourages the state to impose a timeline or other requirements on the LEC to ensure that it is taking concrete steps to enable it to comply with the relevant requirements once the suspension or modification ends.[740] If a state finds that a LEC is not taking such steps necessary to ensure compliance on a date certain, we find that such a determination would be sufficient for the state immediately to revoke the suspension or modification as no longer satisfying the "public interest" criteria.

279. We also offer guidance regarding the substantive standards that state commissions must apply when evaluating requests pursuant to section 251(f)(2) for a suspension or modification of section 251(b) or (c). The first prong of section 251(f)(2)(A) directs state commissions to determine whether the LEC establishes that absence of the requested suspension or modification would cause a "*significant* adverse economic impact on users of telecommunications services generally."[741] The term "significant" is ambiguous. According to Webster's Dictionary, "significant" means "having or likely to have influence or effect; of a noticeably or measurably large

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[739] 47 U.S.C. § 251(f)(1).

[740] Moreover, if, in the future, we have evidence that states are granting arbitrarily long suspensions/modifications to requesting LECs, the Commission will consider imposing a limit on the number of years that a suspension/modification is appropriate.

[741] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

amount."[742] We find this to be a reasonable definition, and conclude that for an "adverse economic impact" to be "significant" requires that such harm be "measurably large." Moreover, the state commission must evaluate the net impact "on users of telecommunications services *generally*."[743] We conclude that state commissions must consider users of telecommunications services more broadly, rather than focusing narrowly on impacts on isolated groups of users, such as customers of the LEC requesting the suspension or modification. Further, state commissions must weigh the overall impact on such users, including not only any adverse impacts on particular users, but whether there are other associated benefits of the regulatory requirements to telecommunications users. For example, the reduction in intercarrier compensation payments might lead some carriers to increase some rates, but also should reduce long distance rates, stimulate additional competition in local markets, consistent with the goals of the 1996 Act, and provide additional benefits to end users. We direct states to consider the totality of the circumstances in evaluating the impact on telecommunications users.

280. The second prong of section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that the requested suspension or modification is necessary to "avoid imposing a requirement that is unduly economically burdensome."[744] The Eighth Circuit has interpreted the phase "unduly economically burdensome" to require a state to examine "the full economic

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[742] WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1096 (1991).

[743] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[744] *See* 47 U.S.C. § 251(f)(2)(A)(ii).

burden on the ILEC."[745] Consistent with this interpretation, and our interpretation of section 251(f)(2)(A)(i) above, we conclude that states must evaluate the totality of the circumstances in evaluating the net burden. For example, in evaluating the impact of section 251(b)(5) as we interpret it today, states cannot simply look at the LEC's loss of intercarrier compensation revenues. Rather, the state must consider the full economic impact on the LEC of all the comprehensive reforms we adopt, including the ability of carriers to recover revenues by raising other rates, including the federal SLC, the potential economic savings due to reduced billing costs, fewer disputes and litigation regarding the classification of traffic, and the possibility that a carrier may receive universal service support if its financial integrity is threatened.

281. The third prong under section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that compliance with section 251(b) or (c) may be "technically infeasible."[746] We do not believe that any carrier will be able to establish that implementation of our intercarrier compensation reforms is "technically infeasible," considering that carriers generally are exchanging and billing for traffic today, and our rules adopted in this order should merely simplify this process. Thus, we recommend that state commissions scrutinize rigorously any claims of technical infeasibility, particu-

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[745] *Iowa Utils. II*, 219 F.3d at 761. The Commission initially interpreted undue economic burden to mean the "undue economic burden beyond the economic burden that is typically associated with efficient competitive entry." 47 C.F.R. § 51.405(d). The Eighth Circuit vacated this reading of the statute. *See Iowa Utils. II*, 219 F.3d at 760-61.

[746] 47 U.S.C. § 251(f)(2)(A)(iii).

larly if the LEC is paying and/or receiving intercarrier compensation today.

282. Even if a state finds that a LEC satisfies the requirements for a temporary suspension or modification under section 251(f)(2)(A), section 251(f)(2)(B) provides that a state commission cannot grant a petition for suspension or modification unless it also finds that granting the requested petition is "consistent with the public interest, convenience, and necessity."[747] In light of the compelling need to adopt comprehensive reform of existing intercarrier compensation regimes as described above,[748] the Commission urges states to use caution and consider carefully the ramifications of granting any suspension or modification, particularly regarding petitions seeking relief from section 251(b)(5). Indeed, any suspension or modification that continues to treat traffic under different rate structures opens the door for continued regulatory arbitrage and disputes. Such action would undermine the tremendous public interest benefit associated with treating all traffic the same.

283. The Act is silent on what occurs if a state grants a suspension or modification of the section 251(b) or (c) obligations. We find that this silence creates ambiguities and could lead to inconsistent results following a modification or suspension under section 251(f)(2). We are concerned that a suspension or modification of section 251(b)(5) could result in exactly the kind of disparate treatment that we intend to correct with our actions today. Pursuant to our authority under section 201(b), as well as our authority to interpret section 251(f),[749] we

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[747] 47 U.S.C. § 251(f)(2)(B).

[748] *See supra* section V.A.3.

[749] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

therefore adopt rules specifically addressing certain of the implications of a suspension or modification of our intercarrier compensation rules.[750]

284. First, to minimize inconsistency and the possibility that the reforms we adopt today could be undermined, we extend our symmetry requirement for reciprocal compensation rates at the end of the transition period described in Part V.B to any suspension or modification of our section 251(b)(5) reciprocal compensation rules and requirements. If a LEC receives a suspension or modification of our reciprocal compensation pricing methodology, for example, all other LECs and CMRS providers that exchange traffic with the LEC receiving the suspension or modification will likewise be entitled to charge that LEC those same rates that the LEC charges them for the duration of such suspension or modification. We conclude that this symmetry requirement is in the public interest and will reduce disputes, arbitrage, and transaction costs. Indeed, a contrary result that would permit different terminating rates in the same geo-

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[750] Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act." 47 U.S.C. § 201(b); *see also* 47 U.S.C. § 154(i) ("The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions."). "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'" *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. As the Supreme Court has confirmed, this grant of authority necessarily includes section 251(f). *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385 (holding that the Commission has "jurisdiction to promulgate rules . . . regarding rural exemptions"); *see also id.* at 378 n.6 ("[T]he question in theses cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

graphic area would not be in the public interest and likely would lead to the same disputes we have today. If a state attempts to avoid this symmetry requirement by granting a LEC a suspension or modification of any section 251(b)(5) reciprocal compensation obligation and the state fails to require symmetric rates, we will invoke our authority under sections 201 and 332 of the Act to ensure that all carriers exchanging traffic with that LEC pay the same rate for terminating all traffic.

285. Second, if a state grants any suspension or modification that is more than 1 year in duration, we require the state to take a fresh look to determine whether such suspension/modification continues to satisfy the statutory test in light of possible changes in circumstances. To this end, 90 days before the 1-year anniversary of the grant of the suspension or modification, the LEC must file a petition demonstrating that the suspension or modification continues to satisfy the statutory criteria. In the intervening time, for example, a state may have rebalanced rates, the LEC may have increased its end-user charges, or other relevant changes may have occurred. Those actions may have obviated the need for the suspension or modification or, at a minimum, could result in the need for changes to the terms and duration of the suspension or modification. In such a review, the LEC continues to have the burden of demonstrating that the section 251(f)(2) criteria remain satisfied. We conclude that states should act upon such a fresh look within the 180 days for new petitions set forth in section 251(f)(2).[751]

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[751] 47 U.S.C. § 251(f)(2) ("The State commission shall act upon any petition filed under this paragraph within 180 days after receiving such petition.").

d. Existing Agreements

286. Below we discuss the effect of our intercarrier compensation reforms on certain types of existing agreements.

287. *Interconnection agreements.* With respect to interconnection agreements, we do not disturb the processes established by section 252 of the Act. As discussed above, the intercarrier compensation reforms we adopt will necessitate that states implement our new reciprocal compensation methodology. We expect that incumbent LECs and competing carriers will implement the reciprocal compensation changes as directed by section 252 of the Act.[752] We make clear that our actions today constitute a change in law, and we recognize that interconnection agreements may contain change of law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.[753] Verizon raises a concern regarding the impact on contracts in "evergreen" status, which Verizon describes as "contracts that have reached the end of their terms but remain in effect pend-

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[752] *See* 47 U.S.C. § 252.

[753] *See Triennial Review Order*, 18 FCC Rcd at 17404, para. 700. Although section 252(a)(1) and section 252(b)(1) refer to requests that are made to incumbent LECs, we have interpreted that in the interconnection agreement context to mean that either the incumbent or the competitive LEC may make such a request, consistent with the parties' duty to negotiate in good faith pursuant to section 251(c)(1). *See Triennial Review Order*, 18 FCC Rcd at 17405, para. 703 n.2087; *see also* 47 U.S.C. §§ 251(c)(1), 252(a)(1), (b)(1). We believe that this adequately addresses concerns about existing interconnection agreements that do not include express change of law provisions.

ing entry into new contracts."[754] Given that the comprehensive reforms today are necessary to eliminate arbitrage and reduce disputes, we believe it is appropriate for carriers to take a "fresh look" at their interconnection agreements in "evergreen" status, including agreements that lack a change-of-law provision, and follow the section 252 process of negotiation and arbitration. We also note that, pursuant to section 251(a)(1), carriers remain free to negotiate alternative arrangements.[755]

288. *Commercial arrangements.* As discussed above, the intercarrier compensation reforms will require carriers to make certain changes to their tariffs relating to carrier-to-carrier charges, and potentially also SLCs. We do not, however, abrogate existing contracts or otherwise allow for a "fresh look" in light of our reforms.[756]

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[754] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 5-6 (urging that any new intercarrier compensation regime displace such contracts). By the same token, we decline to insulate existing interconnection agreements from the section 252 processes to the extent that some commenters propose that they remain in effect. *See, e.g.*, Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 04-36, 06-122, 05-195, CC Docket Nos. 01-92, 96-45, 99-68, Attach. at 13 (filed Oct. 7, 2008) (proposing that the Commission "order that those prior arrangements should at least presumptively remain in force after the implementation of a new, unified . . . rate regime").

[755] 47 U.S.C. § 251(a)(1).

[756] Several commenters request that the Commission give them a fresh look at existing contracts. *See, e.g.*, Letter from Richard R. Cameron and Teresa D. Baer, Counsel for Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 08-152; CC Docket Nos. 01-92, 99-68, 96-45 at 2 (filed Sept. 18, 2008) (asking that the Commission "provide an 18-month window within which carriers can reconfigure their interconnection facilities without incurring reconfiguration charges or early termination liabilities under existing transport contracts"); Ad Hoc *ICC FNPRM* Comments at 22-24 (ar-

As the Commission has recognized, for example, early termination provisions can be mutually beneficial by giving providers greater assurance of cost recovery, and giving customers (whether wholesale or end-users) discounted and stable prices over the relevant term.[757] Indeed, allowing for a fresh look could result in a windfall for customers that entered long-term arrangements, in exchange for lower prices, as compared to other customers that avoided early termination fees by electing shorter contract periods at higher prices.[758] Rather than adopt a rule that these commercial arrangements must be reopened, we will leave such issues to any change-of-law provisions in these commercial arrangements, or to commercial negotiations among the parties.[759]

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guing that customers should be allowed to opt out of existing contracts); Earthlink *ICC FNPRM* Reply at 7 (arguing that end users should have the opportunity to negotiate different terms and, if renegotiation is not possible, be permitted to terminate existing contracts without liability).

[757] *See, e.g., Triennial Review Order*, 18 FCC Rcd at 17400, 17402-03, paras. 692, 697-99; *see also, e.g.*, AT&T *ICC FNPRM* Reply at 17-19 (arguing against giving end users a fresh look at existing contracts). To the extent that there is evidence that particular termination penalties are inappropriate, the Commission can resolve such a matter through an enforcement proceeding. *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 698.

[758] *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

[759] This situation is thus different than cases where the Commission found that certain contract provisions might adversely affect competition or where end-user customers would be denied the benefits of new Commission policy absent a fresh look opportunity. *See, e.g., Local Competition First Report and Order*, 11 FCC Rcd at 16044, para. 1094; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7350, para. 21 (1993) (allowing a fresh look at agreements in "situations where excessive termination liabilities would affect competition for a signifi-

2. Revenue Recovery Opportunities

289. In the preceding sections of this order, we adopt fundamental changes to the existing intercarrier compensation regimes. These reforms are designed to unify and simplify these mechanisms, consistent with the framework Congress adopted in the 1996 Act. This new approach will result in overall reductions in interstate and intrastate intercarrier compensation rates.[760] In this section, we address the extent to which revenue reductions from carrier-to-carrier charges may be replaced through end-user charges and new universal service support. In prior intercarrier compensation reforms, the Commission largely replaced reductions in intercarrier compensation revenues through a combination of increased end-user charges and new universal service funding.[761] Our actions here carefully balance the need to ensure reasonable revenue recovery by carriers against the potential adverse impact on consumers of increased end-user charges, and the pressure placed on the universal service program to the extent that new subsidies are made available.

290. As an initial matter, we increase the caps on interstate SLCs, and we permit incumbent LECs to increase their SLCs up to the new caps to recover lost interstate and intrastate intercarrier compensation revenues. We also enlist the aid of the Separations Joint Board to evaluate the need for further increases in inter-

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cant period of time"); *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5907, para. 151 (1991) (giving customers of AT&T 90 days to terminate their contracts without penalty to let them "tak[e] advantage of 800 number portability when it arrives").

[760] *See supra* paras. 186-268.

[761] *See supra* paras. 159-185.

state end-user charges to recover any net loss in interstate and intrastate intercarrier compensation revenues, and to evaluate the conditions under which carriers may seek additional universal service funding. To limit the increase in the total universal service fund, we establish certain preconditions that carriers must satisfy before they can receive additional universal service funding to compensate for lost intercarrier compensation revenues.

a. End-User Charges

291. In this section, we consider whether revenue reductions from reformed carrier-to-carrier charges should be replaced to any extent by increases in end-user charges, as the Commission has done in some prior intercarrier compensation reform proceedings.[762] The Commission has acknowledged that "[t]he concept that users of the local telephone network should be responsible for the costs they actually cause is sound from a public policy perspective and rings of fundamental fairness," and also helps ensure "that ratepayers will be able to make rational choices in their use of telephone service."[763] Importantly, however, the Commission also has maintained "safeguards that ensure that the rates consumers pay . . . remain well within a zone of reasonableness."[764] To per-

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[762] *See, e.g., First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682; *Access Charge Reform Order*, 12 FCC Rcd 15982; *CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613.

[763] *First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 686, para. 7.

[764] *CALLS Order*, 15 FCC Rcd at 12976, para. 33; *see also, e.g., 1983 Access Charge Order*, 93 FCC 2d at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund"

mit carriers to recover at least part of their lost intercarrier compensation revenues, we raise the caps on interstate SLCs as described below, which we find to be within the "zone of reasonableness" and which should not have a significant adverse effect on telephone penetration. We also enlist the help of the Separations Joint Board to consider the need, if any, for further increases in end-user charges and certain other revenue recovery issues.

292. The record reveals a wide variety of proposals for modifying interstate end-user charges in response to reductions in intercarrier compensation rates. The majority of these proposals advocate increasing the caps on the interstate SLCs. The interstate SLC is a flat-rated charge that recovers the interstate portion of local loop costs from an end user. Under our current rules governing incumbent LECs, SLCs are subject to a cap that varies based upon whether the line is: (a) a primary residential or single-line business line; (b) a non-primary residential line; or (c) a multi-line business or Centrex line.[765] Some parties propose specific increases in SLC caps to offset a portion of the revenues lost through mandated reductions in intercarrier compensation—including both reductions in interstate and intrastate revenues.[766] Other

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and "[s]uch a result would not be consistent with the goals of the Communications Act").

[765] For price cap and rate-of-return carriers, the current SLC cap for residential and single-line business lines is $6.50, 47 C.F.R. §§ 69.104(n)(1)(ii)(C), 69.152(d)(1)(ii)(D), and the current SLC cap for multi-line business and Centrex lines is $9.20, 47 C.F.R. §§ 69.104(o)(1)(i); 69.152(k)(1)(i). Price cap carriers currently also have a SLC cap of $7.00 for non-primary residential lines. 47 C.F.R. § 69.152(e)(1)(i).

[766] *See, e.g.*, ICF *ICC FNPRM* Comments, App. C at C-7; NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7; Letter

parties contend that most or all of a carrier's replacement of lost intercarrier compensation revenues should come from increased SLCs.[767] On the other hand, some consumer groups assert that no increase in SLC caps is warranted in response to reductions in intercarrier compensation rates.[768]

(i) Current Availability of End-User Charges for Revenue Recovery

293. As an initial matter, we permit incumbent LECs to increase their SLCs up to new caps to recover reductions in interstate intercarrier compensation revenues. In particular, we increase the SLC cap for residential

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from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach at 2-3 (filed Sept. 19, 2008); Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 6-7; Letter from Mary L. Henze, Executive Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket Nos. 05-337, 06-112, 99-68, 07-135, Attach. at 2 (filed Oct. 9, 2008).

[767] *See, e.g.*, Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 5 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Federal Regulatory Affairs, T-Mobile USA, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 8 (filed Oct. 3, 2008); Cox *ICC FNPRM* Comments at 5-6; Eschelon *ICC FNPRM* Comments at 12.

[768] *See* Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. 2 at 22 (filed Sept. 19, 2008); Letter from David C. Bergmann, Assistant Consumer's Counsel Chair, NASUCA Telecommunications Committee, to Marlene H. Dortch, Secretary, FCC, WC Dockets Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Dockets Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286 at 10 (filed Sept. 30, 2008); Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

and single-line business lines from $6.50 to $8.00, the non-primary residential line SLC cap from $7.00 to $8.50, and the multi-line business SLC cap from $9.20 to $11.50. We believe that these modest increases in the SLC caps continue to "ensure that the rates consumers pay for the SLC remain well within a zone of reasonableness."[769] Moreover, we believe that these SLC cap increases also address commenters' concerns about the need for some end-user recovery in light of lost intercarrier compensation revenues. Although some commenters argue for more substantial increases in the SLC caps, we note that there is evidence that incumbent LECs charge rates below even the existing caps in a number of instances. For example, the primary residential and single-line business SLC cap is $6.50, but the national average SLC for those lines is $5.93 based on recent Commission data.[770] Similarly, the non-primary residential line SLC cap is $7.00, but the national average SLC for those lines is $5.81.[771] Further, the multi-line business and Centrex line SLC cap is $9.20, but the national average SLC for those lines is $6.30—nearly $3.00 below the cap.[772] We therefore find it reasonable in the first instance to raise the interstate SLC cap and to allow carriers whose current SLCs are below the new caps to increase those SLCs to recover

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[769] *CALLS Order*, 15 FCC Rcd at 12976, para. 33. We note that section 54.403 of the Commission's rules provides for Tier 1 lifeline support to cover the tariffed SLCs established by rate-of-return and price cap carriers pursuant to sections 69.104 and 69.152 of the Commission's rules. 47 C.F.R. § 54.403.

[770] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1 (providing national weighted average SLCs for price cap carriers and all LECs in the NECA pool as of June 30, 2008).

[771] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1.

[772] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1

revenues lost from interstate and intrastate access charge reductions.[773]

294. To the extent that an incumbent LEC increases its SLCs to recover reductions in its interstate intercarrier compensation revenues and any of its SLCs are still below the relevant caps, we allow those carriers to raise their SLCs further, up to the caps, to recover any net loss in intrastate intercarrier compensation revenues, at least on an interim basis.[774] As a prerequisite for incumbent LECs to increase their SLCs in this manner, we require that the LEC's state retail rates and any intrastate SLC be set at the maximum level permitted under state regulations.[775] This will ensure that revenues from interstate end user charges will not be used to recover intrastate revenue requirements until the carrier has fully availed itself of all available intrastate revenue opportunities under existing law. We also mandate that any increase in interstate SLC revenues that are intended to recover lost intrastate intercarrier compensation revenues be used by the state in ratemaking to reduce costs

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[773] Should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, the difference between the charges it sets and the maximum charges it is allowed to set may not be recovered through increased SLCs, nor may such carriers seek to obtain supplemental universal service support, as described in Part V.C.2, based on that difference.

[774] As discussed below, we are referring to the Joint Board, among other things, the question of whether, and to what extent, net reductions in intrastate intercarrier compensation revenues should be offset by revenues from interstate end-user charges. *See infra* paras. 303-310.

[775] To the extent that a carrier's state retail rates have been deregulated, that carrier may not increase its SLCs to recover any net loss in intrastate intercarrier compensation revenues.

or revenue requirements to be recovered in the intrastate jurisdiction.[776]

295. We find that we have authority to allow recovery of intrastate revenue requirements in this manner. For one, the legacy separations regime does not preclude this action. The Commission historically has provided federal funds to cover at least a portion of costs assigned to the intrastate jurisdiction.[777] Although those decisions relied on the Commission's universal service authority pursuant to section 254, we find that we have authority under section 251(g) to allow recovery of intrastate revenue requirements through interstate SLC rates. Section 251(g) empowers the Commission to subject traffic previously encompassed by section 251(g) to the reciprocal compensation regime of section 251(b)(5), including providing for an orderly transition. Allowing incumbent LECs the option to recover certain lost intrastate intercarrier compensation revenues through increases in the interstate SLC, subject to the new caps, furthers such a transition. In particular, this option helps mitigate any need incumbent LECs might have to seek increases in state rates due to decreases in intrastate intercarrier compensation revenues during the initial stages of the transition, pending the Separations Joint Board referral and subsequent Commission action. We also acknowledge that interstate

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[776] *Cf. Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20486-87, para. 106 (1999) (*Universal Service Ninth Report and Order*) (specifying that "hold-harmless" universal service support "should continue to operate through the jurisdictional separations process to reduce book costs to be recovered in the intrastate jurisdiction.").

[777] *See, e.g., Universal Service Ninth Report and Order*, 14 FCC Rcd 20432 (providing high-cost universal service support for intrastate costs).

SLC charges are governed by sections 201 and 202 of the Act, and that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking."[778] In the past, the Commission has, in fact, adopted regulatory approaches that deviated from cost-based ratemaking.[779] We find such an approach warranted here to help mitigate regulatory burdens during the transition, as described above.

296. In sum, we adopt increased SLC caps to allow incumbent LECs to recover some or all of their net loss in intercarrier compensation revenues resulting from rate reductions pursuant to this order. In particular, to recover those lost revenues, we permit incumbent LECs to increase each of their SLCs up to the new caps.

297. With respect to non-incumbent LECs, we note that most interstate rates of such providers are not subject to *ex ante* regulation by the Commission. Thus, we

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[778] *Access Charge Reform Second Order*, 12 FCC Rcd at 16619-20, para. 44 (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)).

[779] *See, e.g., LEC Price Cap Order*, 5 FCC Rcd 6786 (adopting price cap regulation, under which rates are not tied directly to cost); *Pricing Flexibility Order*, 14 FCC Rcd 14221, 14307, para. 168 (once price cap carriers are granted pricing flexibility, they lose the option of a low end adjustment, which would permit incumbent LECs earning rates of return less than 10.25% in a given year to increase their price cap indices to a level that would enable them to earn 10.25%.); *MCI Telecomms. Corp. v. U S WEST Commc'ns, Inc.*, File Nos. E-97-08, E-97-20 through 24, Memorandum Opinion and Order, 15 FCC Rcd 9328, 9334, para. 14 (2000) (finding that incumbent LECs' non-cost-based PICC did not violate section 201(b) given the Commission's prior establishment of a safe harbor).

allow those carriers to recover any net loss in intercarrier compensation revenues in any lawful manner.[780]

(ii) Joint Board Referral of Possible Changes to End-User Charges

298. We enlist the aid of the Separations Joint Board to evaluate the need for any additional increases in interstate end-user rates for carriers to recover any net loss in interstate and/or intrastate intercarrier compensation revenues as a result of the reform measures we adopt today. There are a range of widely divergent proposals in the record regarding the need for additional changes to the SLC caps adopted above as part of comprehensive intercarrier compensation reform. We believe that the information and analysis developed by the Separations Joint Board will be extremely valuable in evaluating these issues.

299. Our decision to seek input from the Separations Joint Board is consistent with section 410 of the Act. Section 410(c) of the Act requires the Commission to refer to the Separations Joint Board any changes to the separations rules being considered through a rulemaking proceeding. Although no changes to the separations rules are at issue here, section 410(c) also authorizes the Commission to refer matters "relating to common carrier communications of joint Federal-State concern to a Federal-State Joint Board."[781] We believe that recommendations from a Joint Board regarding these issues are important to striking the right balance among the various policy goals at stake, relating to traffic that historically

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[780] *Cf. Telephone Number Portability*, CC Docket No. 95-116, Third Report and Order, 13 FCC Rcd 11701, 11725-26, 11773-80, paras. 39, 135-49 (1998) (carriers other than incumbent LECs permitted to recover such costs in any lawful manner).

[781] 47 U.S.C. § 410(c).

has been regulated, in part, by both federal and state jurisdictions. Moreover, the issue of using revenues from interstate end-user charges to recover intrastate revenue requirements is sufficiently related to the underlying separations requirements themselves that we believe the Separations Joint Board possesses highly relevant expertise to provide recommendations on these issues.[782]

300. As described in greater detail below, we refer to the Separations Joint Board certain specific issues regarding possible increases in interstate end-user charges: (i) whether SLC caps should be increased by a fixed amount to recover any net loss in intercarrier compensation revenues; (ii) whether a "flexible" SLC cap should be used in conjunction with an overall benchmark or threshold; or (iii) some combination of those options.

301. *Quantifying Any Increase in End-User Charges.* We refer to the Separations Joint Board several possible approaches for establishing any additional permissible increases in interstate end-user charges, to the extent that any are warranted. First, the Separations

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[782] The Commission has referred non-separations issues to the Separations Joint Board previously. *See, e.g., MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules*, CC Docket Nos. 78-72, 80-286, Further Notice of Proposed Rulemaking, 49 Fed. Reg. 18318, 18318, para. 1 (1984) (referring to a Separations Joint Board issues including: (1) the subscriber line charge for residential and single-line business customers; (2) the transition mechanism for implementing subscriber line charges for these customers; (3) an exemption from the subscriber line charge or other assistance for low income households; and (4) additional assistance for small telephone companies.); *MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules*, CC Docket Nos. 78-72, 80-286, Recommended Decision, 49 Fed. REG. 48325, 48327, para. 9 n.20 (1984) (noting that "[s]ince these issues do not involve the allocation of costs between the jurisdictions, preparation of a Joint Board recommendation is not mandatory.").

Joint Board could directly recommend particular further increases in the SLC caps. Parties here have proposed various levels of SLC cap increases, and different ways to distribute those increases across the different SLC caps. For example, the ICF proposal would result in all SLC caps being increased to $10.00 by the end of a transition period.[783] Under the Missoula Plan's initial proposal, SLC cap increases vary for the three "tracks" or categories of carriers defined in the plan.[784] ITTA proposes a $2.25 increase in each SLC cap by the end of a transition period, subject to a benchmark consisting of SLCs, retail rates, and certain other charges.[785] Other parties, such as CTIA, contend that recovery of lost intercarrier compensation revenues by incumbent LECs should come solely from end-user charges.[786] In contrast, Free Press, NASUCA, and Ad Hoc propose that SLC caps not be increased at all.[787]

302. Second, the Separations Joint Board could recommend a "flexible" SLC cap that would vary depending

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[783] ICF *ICC FNPRM* Comments, App. C at C-7.

[784] NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7.

[785] ITTA Sept. 19, 2008 *Ex Parte* Letter, Attach. at 2-3.

[786] CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 10. *See also, e.g.*, Letter from Norina Moy, Director, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92 at 2 (filed Aug. 7, 2008).

[787] Letter from Ben Scott, Policy Director, Free Press, Washington Office, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. 2 at 22 (filed Sept. 19, 2008); NASUCA Sept. 30, 2008 *Ex Parte* Letter at 10; Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

upon a carrier's other end-user rates and an overall benchmark or threshold. For example, under a recent Verizon proposal, the 'default' SLC caps all would increase to $10.00 by the end of a transition period.[788] However, to the extent that a carrier's relevant end-user rates still are below a proposed benchmark, that carrier's SLC cap would increase as much as needed to reach the benchmark.[789] Thus, the Separations Joint Board could determine a particular benchmark or threshold and allow the SLC cap to vary for each carrier, depending upon how much "headroom" that carrier has under the benchmark, in light of the carrier's other rates. To the extent that the Separations Joint Board recommends this approach, it should specify which carrier rates should be included in the relevant benchmark or threshold.

303. Third, the Separations Joint Board could recommend some combination of the first and second options.

304. In making recommendations on these issues, the Separations Joint Board will consider the extent to which any recommended increases in interstate end-user charges should be used to offset lost intrastate intercarrier compensation, to the extent that decreases in interstate intercarrier compensation revenues already have been recovered. Most comprehensive reform proposals in the record assume that SLC cap increases will be used to offset at least some intrastate revenues.[790] Logically,

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[788] Verizon Sept. 12, 2008 *Ex Parte* Letter at 6-7.

[789] Verizon Sept. 12, 2008 *Ex Parte* Letter.

[790] To the extent that interstate end-user charges are used to offset any lost intrastate intercarrier compensation revenues, we mandate that the states take account of those revenues in their state ratemaking by reducing the intrastate costs or revenue requirement to be recovered through intrastate rates.

however, another alternative is for any increases in the SLC caps to be used only to recover reductions in interstate intercarrier compensation revenues, and to leave it to each state to address lost intrastate intercarrier compensation revenues as appropriate under state law.

305. *Timing.* We direct the Separations Joint Board to issue its recommended decision not later than one year from the effective date of this order. In light of that timetable, we limit the Separations Joint Board to consideration of specific issues we refer in this order.

b. Universal Service Support

(i) Policy Approach

306. We recognize that the actions we take to reform intercarrier compensation will result in reduced revenues for many carriers. As discussed above, carriers have the opportunity to replace certain of those lost revenues through end-user charges.[791] We also acknowledge that, in the past, the Commission has sometimes provided new universal service support to replace reductions in intercarrier compensation revenues.[792] As the Fifth Circuit has recognized, however, "[b]ecause universal service is funded by a general pool subsidized by all telecommunications providers—and thus indirectly by customers—excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market."[793]

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[791] In this order, we do not decide the maximum amount that incumbent LECs ultimately may charge customers in the form of interstate end-user charges. As discussed above, that will depend upon further Commission action based on recommendations from the Joint Board.

[792] *See, e.g., CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613; *see also MAG* Second *FNPRM*, 19 FCC Rcd 4122.

[793] *Alenco*, 201 F.3d at 620.

Thus, excessive universal service subsidization could, perversely, cause undesirable increases in consumers' bills.

307 We note that many companies—in particular price cap carriers—consistently are paying dividends and are using the same supported network to provide both regulated services and non-regulated services. Throughout the course of our comprehensive reform proceedings, commenters have identified this as a concern to be weighed carefully when evaluating the need for universal service support. For example, following the 2005 intercarrier compensation Further Notice, CTIA contended that some rural incumbent LECs already "are overcompensated by universal service support" based on evidence that their "stocks generate returns, measured by market-to-book ratios, far in excess of, and exhibit significantly lower risk premiums than, the supposedly more secure RBOCs."[794] Commenters continue to express concern that existing universal service subsidies too often lead simply to "'high overhead, sumptuous earnings, [and] rich dividends.'"[795] For example, recent news reports indicate that CenturyTel and Embarq still "remain highly profitable—operating margins for both are 27 percent" notwithstanding any competition they face.[796] Parties have argued that there continues to be evidence

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[794] CTIA *ICC FNPRM* Comments at 37 citing Western Wireless Reply, CC Docket No. 96-45, Attach. at 2-5 (filed Dec. 14, 2004) (attaching Economics and Technology, Inc., *Reforming Universal Service Funding for Rural ILECs: An Idea Whose Time Has Come*).

[795] Thomas W. Hazlett, "*Universal Service Telephone Subsidies: What Does $7 Billion Buy?* (*Universal Service Telephone Subsidies*) at 33, *attached to* Core *Missoula Phantom Traffic* Comments, Tab B (quotation omitted).

[796] *A Fair Copper*, FINANCIAL TIMES, Oct. 28, 2008, at 16.

that "[i]nvestors place a higher value on RLEC earnings than on other ILEC earnings. In today's market, the larger ILECs, which do not generate much of their revenues from federal subsidies, are valued much less highly per dollar of profit."[797] While there are "various factors in play" this suggests that "[m]illions of dollars in extra wealth end up in the hands of private investors" by "transferring income from telephone users to phone company stockholders."[798] Indeed, commenters note that "some carriers owned by co-ops pay their members annual dividends that exceed their members' local phone charges."[799] In light of these concerns and the mandates of section 254, we agree with commenters that it is not appropriate to require all universal service contributors to pay into the fund so that these carriers can continue to pay dividends.[800]

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[797] *Universal Service Telephone Subsidies* at 34.

[798] *Universal Service Telephone Subsidies* at 34, 70. *See also* Julie Tanner, General Counsel, Chinook Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10, Attach. 1 at 7 (filed Feb. 22, 2008) (arguing that incumbent LECs receiving universal service support "send a comfortable return on investment to investors (and rural cooperative members) with no accountability"); NTCH, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10 at 8 (filed Feb. 22, 2008) ("The object of the [universal service] subsidy is not to prop up high cost legacy companies and technologies or assure their profitability, nor to add to the profits of wireless carriers.").

[799] *Universal Service Telephone Subsidies* at 70.

[800] *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 68 ("Even if excessive support does not lead to unaffordable increases in rates for non-subsidized subscribers, requiring those customers to pay more than is necessary in order to excessively subsidize rates for other [services] (or worse yet, to finance high dividend payments to owners of rural ILECs) is not consistent with maintaining just and reasonable rates."); Time Warner Telecom *Missoula Phantom Traf-*

308. Thus, rather than guaranteeing revenue neutrality, as some commenters propose,[801] we take steps here to ensure that any new universal service subsidies are targeted carefully to situations where they are most crucially needed. In particular, far from the regulated monopolies of years past, significant marketplace developments have resulted in additional revenue opportunities for carriers. As NASUCA observes, "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets."[802] "By way of illustration," NASUCA points out that "using their common local loop platform, carriers are now generating billions of dollars in digital subscriber line ("DSL") revenues that they did not generate five or ten years ago."[803] Indeed,

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fic Comments at 10 (noting that "RBOCs are already realizing substantial profits from [network] investments, easily compensating for any loss in access payments that they may face" and that "a high [universal service] contribution level may approach the point at which the USF charges imposed upon end-users actually threaten the goal of universal service").

[801] *See, e.g.*, CenturyTel Sept. 19, 2008 *Ex Parte* Letter, Attach. at 5 (arguing that revenue neutrality should be a fundamental goal of comprehensive intercarrier compensation reform); Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 04-36, 05-337, 06-122, Attach. at 3 (filed Sept. 16, 2008) (arguing that, if the Commission does not adopt the Missoula Plan, it should establish a mechanism for "rural RoR ILECs that allows for full recovery of the revenues lost as a result of the change in intrastate access rates and structure, on a revenue neutral basis."). *See also* Rural Alliance *ICC FNPRM* Comments at 21 (arguing that decreases in intercarrier compensation rate levels should be offset from the USF or another revenue replacement mechanism).

[802] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[803] Comments of the National Association of State Utility Consumer Advocates to Refresh the Record, CC Docket Nos. 96-45, 02-6, 01-92,

Time Warner Telecom has pointed to evidence that, for some carriers, "revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services."[804] Thus, Free Press observes that "the unregulated revenue streams of rate-of-return and price cap Local Exchange Carriers serving in high-cost areas" are the "500 pound gorilla in the room," and it contends that "these revenues" should be "considered in the discussions of 'need' for the purposes of universal service."[805] We agree that such "new and growing source[s] of revenues should mitigate the impact of inter-

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00-256, 96-262, 99-68, 80-256, WC Docket Nos. 05-337, 07-135, 06-122, 05-195, 03-109, 02-60 at 6 (filed July 7, 2008) (NASUCA July 7, 2008 Supp. Comments). *See also id.* at 10 ("Adding insult to injury, there is no consideration in the Missoula Plan of the additional revenues that ILECs gain from serving new broadband lines which are outside of the current ICC system. In other words, ILECs are losing lines and MOU as consumers drop traditional landlines and add broadband lines to access the Internet. However, the revenue gains from broadband line additions are totally out of the picture as far as the Missoula Plan is concerned.").

[804] Time Warner Telecom *Missoula Phantom Traffic* Comments at 10 ("According to AT&T, the revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services. As AT&T stated in its Annual Report, '[w]e have found that when customers add broadband to a basic package, they are 40 percent less likely to switch to another provider, and average revenue per customer jumps nearly 120 percent.' It would make little sense for the ratepayers to subsidize the ILECs' already profitable business decisions.").

[805] Free Press Oct. 13, 2008 *Ex Parte* Letter at 6. *See also id.* at 6-7 ("While we'd like the Commission to consider a carrier's entire revenue stream before allowing increased USF support to offset lost access revenues" to the extent that there is such support it "should be confined to rate-of-return carriers only.").

carrier compensation reform for rural and other carriers."[806]

309. We are concerned that universal service support be targeted to those companies whose reduced intercarrier compensation revenues truly are needed to continue providing quality service at affordable rates, and that it should not simply enable the company to pay bigger dividends to shareholders or pad a company's bottom line. We find that, because of their different regulatory treatment, price cap incumbent LECs and rate-of-return incumbent LECs should be treated differently. For price cap carriers, we adopt the proposal of various commenters to consider all a company's costs and revenues—both regulated and non-regulated—before providing new universal service support.[807] Thus, price cap incumbent LEC seeking universal service funding to replace lost intercarrier compensation revenues must make such a showing to the Commission when petitioning for such support.

310. We also agree with proposals that carriers fully avail themselves of existing opportunities for end-user

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[806] NASUCA July 7, 2008 Supp. Comments at 6. Indeed, there is some indication that carriers may be earning excessive returns even with respect to their regulated services. *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 66-67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25% rate of return on its regulated interstate switched access services, including 32.12% for 1997-98, 30.26% for 1999-2000; 35.29% for 2001-02; and 15.01% for 2003-04).

[807] *See, e.g.*, Letter from Mary C. Albert, Assistant General Counsel, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 05-337, 04-36 at 1 (filed Oct. 2, 2008); NASUCA July 7, 2008 Supp. Comments at 32-34; Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1-2 (filed Oct. 7, 2008).

recovery before collecting new universal service subsidies.[808] To the extent that regulators have determined that rates at a particular level are reasonable, we find it appropriate for carriers to charge those rates in the first instance, rather than pricing below those levels in order to foist recovery of the additional revenues on universal service contributors. Consequently, as additional preconditions for receiving new universal service support, a price cap carrier must show that its federal SLC, state SLC (if any), and state retail local service rates are at the maximum levels permitted under existing applicable law.[809]

311. In conjunction, we conclude that the conditions we adopt as prerequisites for obtaining new universal service support adequately target that support to carriers with a genuine need without unduly burdening consumers with excessive new universal service contribution burdens.[810]

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[808] *See, e.g.*, Letter from Donna Epps, Vice President—Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1-2 (filed Oct. 2, 2008); Letter from Robert W. Quinn, Jr., Senior Vice President—Federal Regulatory, AT&T, to Kevin Martin, Chairman, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 07-135, 05-337 at 5-7 (filed July 17, 2008); Letter from Anthony M. Alessi, Senior Counsel, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 3-5 (filed May 23, 2008); Cox *ICC FNPRM* Comments at 12-13.

[809] Although we do not adopt a particular revenue benchmark here, as some commenters propose, the Joint Board may well recommend such an approach. Thus, depending upon the Joint Board's proposal, and the Commission's subsequent action, maximum federal SLCs and/or state retail local rates might be determined, in part, by such a benchmark.

[810] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms

312. We recognize that interstate rate-of-return carriers present a special situation, because under our rules they must be provided an opportunity to earn the rate of return established by our orders.[811] As a result, we find it inappropriate to impose the same conditions before interstate rate-of-return carriers can recover universal service support.[812]

(ii) Legal Authority

313. Consistent with our mandate to "ensure that universal service is available at rates that are just, reasonable, and affordable," we establish a new supplement to IAS and ICLS universal service funding mechanism.[813] As we did recently in two other Commission orders that reformed interstate switched access charges, we include here additional universal service funding to keep retail

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adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

[811] *See, e.g.*, Free Press Oct. 13, 2008 *Ex Parte* Letter at 6-7 (noting that, to the extent that there is universal service support to address any net loss in intercarrier compensation revenues, it "should be confined to rate-of-return carriers only."). *But see, e.g.*, *GCI Missoula Phantom Traffic* Comments at 66-67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25 percent rate of return on its regulated interstate switched access services).

[812] *See, e.g.*, Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter, Attach. at 2 (requesting, among other things, that the Commission ensure that "[s]upplemental interstate common line support (ICLS) (i.e., "the restructure mechanism") is automatically available for carriers that are currently under RoR regulation in the interstate jurisdiction without any other conditions applying").

[813] 47 U.S.C. § 254(i) (requiring that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."); *see also* 47 U.S.C. §254(b)(1) (stating that "[q]uality services should be available at just, reasonable, and affordable rates").

rates affordable while ensuring that maintaining affordable rates does not unduly threaten the financial viability of rate-regulated incumbent LECs.[814] Our decision to establish a new funding mechanism is also consistent with our general authority under section 4(i) of the Act because it furthers our universal service objectives.[815] Mindful of our obligation to ensure that these new subsidies are made available only where essential, however we make new universal service subsidies available subject to specific conditions that will target the support to only those carriers whose circumstances merit it.

(iii) Access to Universal Service Support

314. As discussed below, we limit access to universal service support to incumbent LECs that meet certain preconditions. As an initial matter, we find that limiting such support to incumbent LECs is consistent with their position in the marketplace and the resulting regulatory constraints on their pricing behavior. In a series of orders in the Competitive Carrier proceeding, the Commission distinguished two kinds of carriers—those with individual market power (dominant carriers) and those with-

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[814] *See, e.g., CALLS Order*, 15 FCC Rcd at 12971, para. 24; *MAG Order*, 16 FCC Rcd at 19669-70, para. 132.

[815] Section 4(i) provides that the Commission may "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). Prior to the enactment of section 254 (as part of the 1996 Act), sections 1 and 4(i) provided authority for the Commission's adoption of a universal service fund. *See Rural Telephone Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988). *See also New England Telephone and Telegraph Co. v. FCC*, 826 F.2d 1101, 1107 (D.C. Cir. 1987) (describing section 4(i) as a "wide-ranging source of authority"), *cert. denied*, 490 U.S. 1039 (1989).

out market power (non-dominant carriers).[816] The Commission found it appropriate to continue to subject dominant carriers to full regulation under Title II of the Communications Act.[817] Incumbent LECs are dominant carriers in their provision of switched access services and, as a result, are subject to rate regulation.[818] This rate regulation comes in two forms—regulation of intercarrier charges and regulation of end user charges. The Commission regulates interstate end-user charges of incumbent LECs, while the states generally regulate those carriers' intrastate end-user rates. Unlike incumbent

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[816] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (*Competitive Carrier First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed. Reg. 17308 (1982); Second Report and Order, 91 FCC 2d 59 (1982) (*Competitive Carrier Second Report and Order*); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28292 (1983); Third Report and Order, 48 Fed. Reg. 46791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (*Competitive Carrier Fourth Report and Order*), *vacated*, *AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), Fifth Report and Order, 98 FCC 2d 1191 (1984) (*Competitive Carrier Fifth Report and Order*); Sixth Report and Order, 99 FCC 2d 1020 (1985), *vacated*, *MCI Telecomms. Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985) (*Competitive Carrier Sixth Report and Order*), *aff'd*, *MCI v. AT&T*, 512 U.S. 218 (1994) (collectively, the *Competitive Carrier* proceeding); *see* 47 C.F.R. § 61.3(q), (y).

[817] *Competitive Carrier First Report and Order*, 85 FCC 2d at 10-11, para. 26.

[818] *See Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112; CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440, 16484, para. 90 (2007).

LECs, competitive carriers (e.g., such as competitive LECs, CMRS providers, and non-dominant IXCs) lack market power and are considered non-dominant. As a result, their end-user charges are not subject to comparable rate regulation by the Commission and the states.[819]

315. Because incumbent LECs, as a result of their classification as dominant carriers, have had their end-user charges regulated (both in terms of rate levels and rate structures), they have less flexibility than other carriers to recover decreased intercarrier revenues through end-user charges. As a result, they are less likely to be able to recover reductions in intercarrier compensation revenues resulting from the actions we take today. Accordingly, we conclude that access to universal service support should be limited to incumbent LECs that meet the necessary preconditions. For this reason, we disagree with parties that advocate making funding available to all carriers, both incumbent and competitive[820] or

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[819] For instance, the Commission has declined to regulate the SLCs of competitive LECs. *See Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10870 n.8 (2002) (subsequent history omitted); *see also CLEC Access Charge Order*, 16 FCC Rcd at 9955, para. 81 (stating that competitive LECs competing with CALLS incumbent LECs are free to build into their end-user rates a component equivalent to the incumbent LEC's SLC).

[820] *See, e.g.*, T-Mobile Oct. 3, 2008 *Ex Parte* Letter at 9 & n.14 (arguing that "any ICC replacement mechanism be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality."). Sprint argues that a fund that compensates only incumbent LECs (and not competitive LECs, wireless carriers, and IXCs) for lost access revenues is "blatantly anti-competitive." Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket No. 04-36 at 4

to all carriers that currently receive access charge revenues.[821] As discussed above, competitive carrier end-user charges are not subject to rate regulation, and those car-

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(filed Oct. 1, 2008). Many CMRS carriers maintain that any replacement mechanism must be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality. *See, e.g.*, Leap *ICC FNPRM* Reply at 18; Allied National *ICC FNPRM* Comments at 10; CTIA *ICC FNPRM* Comments at 37; SouthernLINC *ICC FNPRM* Reply at 9; RCA *ICC FNPRM* Comments at 4; US Cellular *ICC FNPRM* Comments at 4; T-Mobile *ICC FNPRM* Comments at 26; Dobson and American *ICC FNPRM* Comments at 10.

[821] *See, e.g.*, ICF *ICC FNPRM* Comments at 32-33 (stating that any funding should be temporary and limited to those that lose access revenue because of intercarrier compensation reform); USTA *ICC FNPRM* Comments at 40 (arguing that funding should not compensate wireless carriers and that it should not be portable); CCAP *ICC FNPRM* Reply at 14 (stating that funding "should not be portable to competitive eligible telecommunications carriers."); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, Attach. at 7 (filed Oct. 12, 2008) (asserting that funding should compensate only LECs that have lost revenues because of intercarrier compensation reform); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, Docket Nos. 01-92, 04-36, 96-45, 05-337, Attach. at 9 (filed Oct. 3, 2008) (arguing that the Commission should "limit duplicative networks" by prohibiting wireless carriers and other carriers that do not receive access compensation from benefiting from the fund); Letter from Alex J. Harris, Vice President—Regulatory, Frontier, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 16, 18 (filed May 11, 2005) (proposing that the funding be confined to incumbent LECs in rural study areas but available to all carriers that lost access revenues in non-rural study areas); *see also* Letter from Brad E. Mutschelknaus, Counsel to XO Communications, Kelley Drye & Warren LLP, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 06-122, Attach. at 4 (filed Oct. 3, 2008) (contending that revenue replacement funding should either be "competitively neutral" or limited to only rate-of-return carriers).

riers have the opportunity to recover lost access revenue through any legally permissible means.[822] We also reject an approach that would limit funding to rural rate-of-return carriers.[823] Incumbent LECs subject to price cap regulation also are subject to regulatory constraints on end-user charges, and we therefore decline to categorically deny universal service funding to particular types of incumbent LECs.[824]

316. *Supplemental IAS for price cap carriers* Consistent with the policy approach discussed above, we fur-

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[822] Some competitive LECs claim that, in practice, they have little opportunity to recover their costs because the incumbent LEC, whose prices are regulated, effectively sets a ceiling on the prices they charge. *See, e.g.*, COMPTEL *Missoula Phantom Traffic* Comments at 7. Although we acknowledge that, in a homogeneous goods market with a single price, such an argument might be plausible, we do not find such assumptions apply in modern telecommunications markets. In particular, with modern telecommunications technology, carriers are offering an expanding number of new services and marketing them through a variety of bundled service offerings. As a result, telecommunications services are becoming much more of a differentiated product, and competitors have greater opportunity to offer niche services. In light of these developments, we find unpersuasive arguments that competitors are effectively price regulated and thus do not have an opportunity to recover lost access revenues.

[823] *See, e.g.*, NCTA *ICC FNPRM* Comments at 11 (arguing that funding should be limited to "non-Tier 1 rural carrier[s]"); NTCA *ICC FNPRM* Comments at 56 (asserting that funding "should be targeted at rural ILECs exclusively"); Comments of the Rural Alliance, CC Docket No. 01-92 at 4 (filed Jun. 27, 2008) (stating that the fund should only compensate rural rate-of-return carriers that lose access revenues).

[824] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

ther find it necessary to establish certain requirements that an incumbent LEC must satisfy to receive the new universal service subsidies. Before seeking universal service funding, interstate price cap incumbent LECs must first demonstrate that their end-user charges are at the maximum allowable rate levels. Thus, price cap incumbent LECs must show that they are charging the maximum interstate SLCs permitted under applicable law, and they must make the same showing with respect to any intrastate SLCs. In addition, price cap incumbent LECs must demonstrate that their retail local rates are at the maximum allowable amount based on applicable state regulation. Price cap incumbent LECs operating in states where retail rates are deregulated are not entitled to the new universal service funding adopted here. In this case, these price cap incumbent LECs will be similarly situated to competitive carriers, because without regulation, they have the opportunity to recover lost access revenues due to intercarrier compensation reform through increased end-user charges.

317. In addition a price cap incumbent LEC may qualify for universal service funding if it can demonstrate that, as a result of reduced and reformed intercarrier charges, and after accounting for increased end-user charges, it is still unable to earn a "normal profit." In the *Local Competition First Report and Order*, the Commission discussed the concept of normal profit and defined it as the "total revenue required to cover all the costs of a firm, including its opportunity costs."[825]

318. As described above, many companies—in particular, price cap carriers—consistently are paying divi-

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[825] *Local Competition First Report and Order*, 11 FCC Rcd at 15854, para. 699.

dends and are using the same supported network to provide both regulated services and non-regulated services.[826] We do not find it appropriate to require all universal service contributors to pay into the fund to provide for "'high overhead, sumptuous earnings, [and] rich dividends'" on the part of these carriers.[827] Indeed, as discussed above,[828] "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets"[829] in addition to other nonregulated services that use "their common local loop platform."[830] Therefore, in determining whether this criterion is met, the Commission will evaluate the total costs and total revenues of the company as a whole, including those from both regulated and non-regulated sources.[831] While this is a more stringent showing than that required of rate-of-return carriers, we find such differences warranted by the different rate regulation frameworks. In light of our reforms, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of-return regulation.[832]

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[826] *See supra* para. 312.

[827] *Universal Service Telephone Subsidies* at 33.

[828] As discussed below, Lifeline customers are exempt from contribution assessments. *See infra* para. 137.

[829] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[830] NASUCA July 7, 2008 *Ex Parte* Letter at 6.

[831] The non-regulated costs and revenues to be included in this calculation are those associated with non-regulated activities involving the common or joint use of assets or resources in the provision of both regulated and non-regulated products and services.

[832] Pursuant to section 61.41(d) of the Commission's rules, once a carrier is subject to price cap regulation, it may not "withdraw from such regulation." 47 C.F.R. § 61.41(d); *see also* 47 C.F.R. § 61.41(b), (c) (requiring conversion from rate-of-return to price cap regulation

319. We recognize that the conditions by which we would make universal service funding available may not ensure that all carriers recover all reduced intercarrier compensation revenues that result from the reforms we adopt here. We reject the assertion by some carriers that any revenue replacement mechanism adopted by the Commission in the context of intercarrier compensation reform must ensure absolute revenue neutrality.[833] We agree with commenters who maintain that the Commission has no legal obligation to ensure that carriers recover every dollar in access revenues lost as a result of

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under certain circumstances). Under section 1.3 of the Commission's rules, however, "any provision of the Commission's rules may be waived by the Commission . . . if good cause therefore is shown." 47 C.F.R. § 1.3. As interpreted by the courts, this requires that a petitioner demonstrate that "special circumstances warrant a deviation from the general rule and that such a deviation will serve the public interest." *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164 (D.C. Cir. 1990) (citing *WAIT Radio v. FCC*, 418 F.2d 1153, 1158 (D.C. Cir. 1969)). In other circumstances in the past, the Commission has found good cause to waiver section 61.41(d) and other related provisions of the Commission's rules to enable operations subject to price cap regulation to convert to rate-of-return regulation. *See, e.g., ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules and Application for Transfer of Control*, CCB/CPD No. 99-1, Memorandum Opinion and Order, 14 FCC Rcd. 14191 (1999); *CenturyTel of Northwest Arkansas, LLC et al., Joint Petition for Waiver of Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Petition for Waiver of Sections 61.41(c) and 69.3(g)(2) of the Commission's Rules*, CC Docket No. 96-45, Memorandum Opinion and Order, 15 FCC Rcd 25437 (Acc. Pol. Div. 2000); *ALLTEL Service Corporation, Petition for Waiver of Section 61.41 of the Commission's Rules*, Order, 8 FCC Rcd 7054 (Com. Car. Bur. 1993) (granting waiver of sections 61.41(c), (d) of the Commission's rules). Likewise, as noted above, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of-return regulation.

[833] *See supra* para. 313.

reform, absent a showing of a taking.[834] We conclude that certain increased end-user charges and narrowly targeted supplemental IAS universal service support will provide a reasonable opportunity to recover revenues lost as a result of our intercarrier compensation reform, and to earn a reasonable profit. Whether a particular price cap incumbent LEC is entitled to any revenue recovery, however, will be considered on a case-by-case basis based on the criteria outlined here.

320. *Supplemental ICLS for rate-of-return carriers.* As discussed above, we recognize that interstate rate-of-return carriers present a special situation, because under our rules they must be provided an opportunity to earn their regulated rate of return. In this regard, we adopt the proposal of OPASTCO/WTA, which we find strikes the proper balance regarding supplemental ICLS support. Thus, the only precondition to an incumbent LEC receiving supplemental ICLS support is that the incumbent LEC is under rate-of-return regulation in the interstate jurisdiction.[835]

321. In addition, we adopt the OPASTCO/WTA proposal that supplemental ICLS consist of two components. The first component compensates rural rate-of-return

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[834] *See, e.g.*, Ad Hoc *ICC FNPRM* Reply at 10-11 (arguing that the Commission has no legal obligation to allow revenue neutrality); CTIA *ICC FNPRM* Comments at 46; Nextel *ICC FNPRM* Comments at 20; T-Mobile *ICC FNPRM* Comments at 13 (intercarrier compensation was not intended to guarantee an ILEC revenue stream or preserve low local rates for a given industry segment, doing so would perpetuate inefficiencies); NASUCA *ICC FNPRM* Reply at 34-38 (arguing that the Commission is not required to provide for revenue neutrality and that revenue neutrality deviates from the Commission's past policy).

[835] Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter, Attach. at 2.

incumbent LECs for all of the revenues lost as a result of the mandated reductions in intercarrier compensation rates that are not otherwise recoverable through increases in SLCs.[836] The second component is available only to those rural rate-of-return incumbent LECs that have committed to the five-year broadband build-out requirement.[837] This component is intended to ensure that those rural rate-of-return incumbent LECs continue to have an opportunity to earn their authorized interstate rate of return, subject to a cap. This component will provide compensation for unrecoverable revenue losses attributable to losses in access lines and interstate and intrastate minutes of use, using 2008 as a base year. The second component remains in effect for the first five years of the transition and is capped at $100 million in year one, $200 million in year two, $300 million in year three, $400 million in year four, and $500 million in year five. Prior to year five, the Commission shall conduct a proceeding to determine if modifications are required. Overall, we find that this approach to supplemental ICLS properly addresses the needs of rural rate-of-return carriers, and their right to an opportunity to recover their authorized rate of return.

D. Measures to Ensure Proper Billing

1. Introduction

322. As explained in Part V.A., the current disparity of rates under existing intercarrier compensation mecha-

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[836] Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter, Attach. at 2. This support will remain available at least through the ten year transition period adopted in this order.

[837] *See supra* Part II.B.3 (describing broadband build-out requirement). *See also* Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter, Attach. at 2.

nisms presents service providers[838] with the opportunity and the incentive to misidentify or otherwise conceal the source of traffic to avoid or reduce payments to other service providers. In this Part, we amend our rules to help ensure the ability of service providers to receive the appropriate compensation for traffic terminated on their networks.[839] More importantly, we believe that the comprehensive compensation reforms we adopt today should significantly reduce service providers' incentives to mislabel traffic or otherwise to try to avoid their financial obligations.[840] Nonetheless, we balance a desire to facilitate resolution of billing disputes with a reluctance to regulate in areas where industry resolution has, in many cases, proven effective. We find that the requirements we adopt here will facilitate the transfer of information to terminating service providers, and improve their ability to identify providers from whom they receive traffic, without imposing burdensome costs. In the event that traffic does not contain the information required by our

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[838] We use the term "service providers" in this section to refer both to carriers that provide telecommunications services and to providers of services that originate calls on IP networks and terminate them on circuit switched networks.

[839] Parties frequently use the term "phantom traffic" in describing this problem. We will not use that term in the regulations we adopt here because there is no consensus as to how it should be defined, nor is such a definition necessary for us to address the underlying issues faced by service providers in billing for traffic they receive.

[840] Similarly, we believe that the transition to a uniform intercarrier compensation rate based on the additional costs methodology described above also will address the access stimulation concerns that have recently been raised. *See supra* para. 185. In the unlikely event that service providers persist in these activities, however, we note that the Commission has an open proceeding in which appropriate responses to such actions may be considered. *See generally Access Stimulation NPRM*, 22 FCC Rcd 17989.

rules, or the provider delivering the traffic does not otherwise provide the required call information, for example by providing an industry-standard billing record, to the provider receiving it, we allow the terminating service provider to charge its highest terminating rate to the service provider delivering the traffic. To the extent that a provider acting simply as an intermediate provider (such as a transit provider) becomes subject to a charge under this provision, that intermediate provider can charge the rate it was charged to the provider that delivered the improperly labeled traffic to it. This will ensure that providers are paid for terminating traffic in those instances, and gives financial incentives for upstream providers in the call path to ensure that the traffic includes proper information in the first instance.

2. Background

323. Problems related to traffic arriving for termination with insufficient identification information arise from the technical systems and processes used to create, transfer, and gather intercarrier compensation billing information. To bill for termination of traffic, a terminating service provider must be able to identify the appropriate upstream service provider, and the location of the caller (or a proxy for the caller's location) in order to determine jurisdiction, which is necessary to determine the appropriate charge under existing intercarrier compensation rules.[841] Calls frequently traverse several net-

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[841] This order initiates a process of unifying terminating intercarrier compensation rates, thereby eliminating the rate distinctions between local and long distance calls. Although knowing the origination point of a call remains important, especially during the period of transition to a unified terminating rate, the origination point is less significant for the purpose of determining intercarrier compensation due.

works to connect the calling and called parties. When the originating and terminating networks are not directly connected, as is the case when calls are delivered via tandem transit service, complications with transmitting and receiving billing information related to a call can arise.[842] Terminating service providers that are not directly connected to originating service providers receive information about calls sent to their networks for termination from two sources: Signaling System 7 (SS7) signaling streams[843] and industry standard billing records,[844] which

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[842] *See, e.g.*, Letter from Patrick J. Donovan, Counsel for PacWest Telecomm, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3-4 (filed Oct. 14, 2005).

[843] SS7 is an out-of-band signaling system that is separate from, but runs parallel to, the public switched telephone network (PSTN) and is used to set up call paths between calling and called parties. The following steps typically occur when SS7 sets up a call path for a wireline LEC to wireline LEC call originating and terminating on the PSTN. When a wireline LEC customer dials a call destined for an end user served by a different wireline LEC, the calling party's LEC determines, based on the dialed digits, that it cannot terminate the call. The SS7 call signaling system then begins the process of identifying a path that the call will take to reach the called party's network. SS7 identifies each service provider in the call path and provides each with the called party's telephone number and other information related to the call, including message type and nature of connection indicators, forward call indicators, calling party's category, and user service information if that information was correctly populated and not altered during the signaling process. *See* Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Sept. 13, 2005) (Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter). SS7 was designed to facilitate call routing and was not designed to provide billing information to terminating carriers. *See* Verizon, *Verizon's Proposed Regulatory Action to Address Phantom Traffic* at 5-7 (Verizon Phantom Traffic White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed

Dec. 20, 2005). Technical content and format of SS7 signaling is governed by industry standards rather than by Commission rules, although Commission rules require carriers using SS7 to transmit calling party number (CPN) to subsequent carriers on interstate calls where it is technically feasibly to do so. 47 C.F.R. § 64.1601.

[844] Industry standard billing records are the other common source of information that terminating service providers not directly connected to originating service providers receive about calls sent to their networks for termination. Billing records are typically created by a tandem switch that receives a call for delivery to a terminating network via tandem transit service. Tandem switches create billing records by combining CPN or Charge Number (CN) information from the SS7 signaling stream with information identifying the originating service provider to provide terminating service providers with information necessary for billing. *See* Verizon Phantom Traffic White Paper at 5-7. The tandem switch creating the billing record identifies service providers from whom it receives traffic using the trunk group number (TGN) of the trunk on which a call arrives. *See* Verizon Phantom Traffic White Paper at 4; *see also* Letter from Glenn T. Reynolds, Vice President Federal Regulatory, BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92, Attach. at 5 (filed Jan. 12, 2006) (BellSouth Jan. 12, 2006 *Ex Parte* Letter). The tandem switch translates the TGN into one of two codes identifying the originating the service provider: Carrier Identification Code (CIC) if the originating service provider is an IXC, or Operating Company Number (OCN) for non-IXC calls. The appropriate CIC or OCN is then added, by the tandem switch, if it is equipped to record such information, to the billing record for the call, which is then forwarded to the terminating service provider. *See* Verizon Phantom Traffic White Paper at 5-7; *see also* Verizon *ICC FNPRM* Reply at 16. Service providers delivering billing records typically use the Exchange Message Interface (EMI) format created and maintained by the Alliance for Telecommunications Industry Solutions Ordering and Billing Forum (ATIS/OBF), an industry standards setting group. *See* ATIS Exchange Message Interface 22 Revision 2, ATIS Document number 0406000-02200 (July 2005).

typically are provided by the intermediate service provider connecting the terminating provider to the originating provider.[846]

324. One significant source of billing problems is traffic routed through an intermediate provider that does not include calling party number (CPN) or other information identifying the calling party.[846] In addition, commenters describe several examples of other situations where traffic arrives for termination with insufficient information to identify the originating service provider.[847] Another source of disputes occurs when terminating service providers find differences when attempting to reconcile SS7 data they record and billing records they receive.[848] Such

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[846] *See* Verizon Phantom Traffic White Paper at 5-7.

[846] The Commission recognized that the ability of service providers to identify the provider to bill appropriate intercarrier compensation payments depends, in part, on billing records generated by intermediate service providers. Thus, the Commission sought comment on whether current rules and industry standards create billing records that are sufficiently detailed to permit determinations of the appropriate compensation due. *See Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4743, para. 133.

[847] For example, when a call bound for a number that has been ported to a different service provider is delivered without the responsible service provider performing a local number portability (LNP) query, the call may be delivered to the wrong end office and then may be rerouted to a tandem switch for delivery to the correct end office. *See* Verizon Phantom Traffic White Paper at 18-19. According to Verizon, neither the end office that reroutes the call nor the tandem switch receiving the rerouted call are able to route the call over an access trunk; the call must be sent over a local interconnection trunk. *See id.* In this scenario, the terminating carrier may have difficulty billing the appropriate charges to the IXC that sent the call.

[848] *See* Letter from Stephen T. Perkins, General Counsel, Cavalier Telephone, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 29, 2005). *See also* Letter from Donna

a reconciliation process will likely be inexact, because SS7 streams were not designed to provide billing information.[849] Similarly, at least one commenter asserts that "problems arise" when terminating service providers "second guess tandem traffic reports and generate their own billing statements for carriers with whom they are indirectly interconnected."[850] In addition to unidentifiable traffic caused by unintended network routing circumstances, as described above, several commenters allege that they receive traffic in which the billing information intentionally has been altered or stripped before the call reaches the terminating service provider.[851] Indeed, numerous parties have described experiencing problems of the sort described above.[852] Several proposals suggesting how the Commission should address this problem

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Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 10 (filed Oct. 21, 2005).

[849] *See* Letter from Donna Epps, Vice President—Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 5 (filed Aug. 1, 2005); Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2.

[850] Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 3.

[851] *See, e.g.*, Balhoff and Rowe *ICC FNPRM* Reply at 10; California Small LECs *ICC FNPRM* Comments at 9; ITCI *ICC FNPRM* Reply at 7; Montana Independent Telecommunications Systems (MITS) et al. *ICC FNPRM* Comments at 14, 20; MITS et al. *ICC FNPRM* Reply at 23-24, 33; NECA *ICC FNPRM* Comments at 16; Rural Alliance *ICC FNPRM* Comments at 108; SureWest *ICC FNPRM* Comments at 7; TDS *ICC FNPRM* Comments at 10; BellSouth Jan. 11, 2006 *Ex Parte* Letter at 6.

[852] *See, e.g.*, Letter from Glenn T. Reynolds, Vice President, Policy, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 12, 2008) (USTA Feb. 12, 2008 Proposal). *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, NECA Petition for Interim Order (filed Jan. 22, 2008) (NECA Petition).

have been filed in the record in this proceeding in recent years.[853] Recently, the United States Telecom Association (USTelecom) filed a proposal that appears to enjoy the broadest industry support of any filed to date.[854] For reasons detailed below, we agree that traffic that lacks sufficient information to enable proper billing of intercarrier compensation charges is a problem. Consequently, we take steps to address the problem and help ensure

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[853] *See, e.g.*, NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2; Letter from Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 6, 2006) (Missoula Plan Supporters Nov. 6 *Ex Parte* Letter or Missoula Plan Call Signaling Proposal); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 4, 2006); Letter from Jeffrey S. Lanning, Associate General Counsel, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006) (MCC/USTA Proposal); Letter from Karen Brinkmann, Attorney for the MidSize Carrier Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 31, 2006) (supporting MCC/USTA Proposal).

[854] *See* USTA Feb. 12, 2008 Proposal; *see also* Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 24, 2008); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2, filed Sept. 19, 2008); Letter from Eric Einhorn, Vice president, Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 et al. (filed Sept. 24, 2008); Comments of Windstream, CC Docket Nos. 99-68, 01-92, 96-45, WC Docket Nos. 08-152, 07-135, 04-36, 06-122, 05-337 at 16 (filed Aug. 21, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Aug. 6, 2008); Letter from Henry Hultquist, Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 17, 2008).

proper functioning of the intercarrier compensation system.[855]

3. Discussion

325. We amend our rules as described below to facilitate the transfer of necessary information to terminating service providers, particularly in cases where traffic is delivered through indirect interconnection arrangements. These new requirements will assist in determining the appropriate service provider to bill for any call. We note that these new requirements generally reflect standard industry practice, as recommended by several commenters.[856] We also amend our rules to establish payment obligations for service providers that send traffic that lacks the information required by our amended call signaling rules to intermediate or terminating service providers or that does not otherwise provide the required call information to the recipient. Incorporating these practices into our rules will facilitate resolution of billing disputes, will provide incentives to help prevent manipulation or deletion of information from signaling streams, and will provide incentives for service providers to ensure that traffic traversing their networks is properly la-

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[855] The rules we adopt herein reflect the Commission's determinations regarding how to address call signaling problems as they relate to unidentified and unbillable traffic. Therefore, we disagree with commenters requesting that we adopt alternative proposals such as the NECA petition or the Missoula Plan Call Signaling Proposal. *See, e.g.*, Letter from Robert F. Aldrich, Counsel to the American Public Communications Council, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01 92 (filed Oct. 21, 2008).

[856] *See, e.g.*, Letter from Paul Garnett, Director, Regulatory Policy, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Jan. 3, 2006); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006).

beled and identifiable, in compliance with the rules we adopt in this order.[857]

a. Signaling Information

326. We agree with the USTelecom Feb. 12, 2008 Proposal concerning the importance of call signaling obligations.[858] CPN is a critical component of call signaling information. When CPN is populated in the SS7 stream by an originating service provider and passed, unaltered, along a call path to a terminating service provider, the terminating provider can use the CPN information to help determine the applicable intercarrier compensation.

327. We agree with commenters[859] that assert that the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call is to require providers to populate, and to prohibit them from stripping or altering, CPN information in the SS7 call signaling stream.[860] In an environ-

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[857] The rules we amend in this order were adopted in a 1995 order addressing Caller ID services. *See Rules and Policies Regarding Calling Number Identification Service—Caller ID*, CC Docket No. 91-281, Memorandum Opinion and Order on Reconsideration, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 11700, 11728, para. 79 (1995) (*Caller ID Order*). In the *Caller ID Order*, the Commission found, inter alia, that the CPN based services to which the rules adopted apply are "jurisdictionally mixed" and the Commission therefore preempted an inconsistent state statute. *Id.* at 11722-23, paras. 62, 85. For these same reasons, to the extent the amendments we make to our call signaling rules in this order conflict with any current or future state statutes, those statutes are preempted. *See id.* at 11728-34, paras. 78-95.

[858] *See* USTA Feb. 12, 2008 Proposal.

[859] *See, e.g.*, USTA Feb. 12, 2008 Proposal; NECA Petition.

[860] Because we agree that requiring population of CPN is the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call, we disagree with proposals to exclude certain types of traffic from this require-

ment where numerous service providers may be involved in the completion of a call, this SS7 signaling information must be passed, unaltered, from one to the next in a call path until it reaches the terminating service provider. We therefore modify our rules to prohibit stripping or altering information in the SS7 call signaling stream. We do not, however, make any changes to the designation of particular fields as mandatory or optional, nor do we otherwise intend to change industry standards that govern the population of the SS7 signaling stream.[861]

328. The record also makes clear that we must expand the scope of our existing rule regarding passing

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ment. *See, e.g.*, Letter from Jim Kohlenberger, Executive Director, The VON Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket 04-36 at 6 (filed Oct. 28, 2008). We note that parties are free to contract with third parties to ensure that these requirements are met. *Cf., e.g., LNP Order*, 22 FCC Rcd 19531 (holding that, where interconnected VoIP providers rely on other carriers for access to numbers, both parties must take the steps needed to comply with the number porting obligations established in that order); *Interconnected VoIP 911 Order*, 20 FCC Rcd 10245 (finding that interconnected VoIP providers might elect to comply with their 911 obligations in party by relying on services provided by third parties).

[861] We take a cautious approach in considering any new or revised signaling requirements. SS7 was designed to facilitate call setup and routing, and action we take here is not intended to interfere with the ability of calls to reach their intended recipient. As Verizon Wireless explains, certain SS7 fields are considered mandatory, while others (including CPN, CN, and JIP) are considered optional. *See* Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2. The distinction is significant, because a call will not be completed if a mandatory field has not been populated. *See* Letter from Thomas Goode, Associate General Counsel, ATIS, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. (filed Feb. 10, 2006). Although CPN is considered optional in the industry standard, our rules, before and after amendment pursuant to this order, require service providers to pass CPN in specified circumstances. *See* 47 C.F.R § 64.1601.

CPN,[862] which currently applies only to service providers using SS7 and only to interstate traffic. We therefore extend these requirements to all traffic originating or terminating on the PSTN, including jurisdictionally intrastate traffic.[863] We also amend our rules to require service providers using MF signaling to pass CPN information, or the charge number (CN) if it differs from the CPN, in the Multi Frequency Automatic Number Identification (MF ANI) field.[864] This rule change will ensure that information identifying the calling party is included in call signaling information for all calls.

329. In addition, we agree with commenters who suggest that our call signaling rules should address CN as well as CPN.[865] Verizon states that, in accordance with industry practice, the CN parameter is not populated in the SS7 stream when it is the same as CPN, but that when the CN parameter is populated, CN is included in billing records in place of CPN.[866] We therefore clarify that populating a CN field with information other than the charge number to be billed for the call, consistent with industry standards, falls within this prohibition. This clarification is not intended to disrupt standard industry practice with regard to using CN in the signaling stream and in billing records. But, we also clarify that

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[862] *See* 47 C.F.R. § 64.1601.

[863] *See supra* note 862.

[864] *See* Missoula Plan at 56; Letter from Brad E. Mutschelknaus, Counsel for XO, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 11-12 (filed Feb. 14, 2006).

[865] *See, e.g.*, NECA Petition; Letter from Cheryl A. Tritt, Counsel for T-Mobile USA, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 6 (filed Feb. 2, 2006); Verizon Phantom Traffic White Paper at 8-10.

[866] *See* Verizon Phantom Traffic White Paper at 8.

the prohibition on altering or stripping signaling information applies to CN as well as CPN. The prohibition on altering or stripping SS7, MF ANI, or CN signaling information obligates intermediate service providers to pass, unaltered, whatever signaling information they receive.

330. The call signaling rules we adopt in this order will help ensure that signaling information is passed completely and accurately to terminating service providers. These rules are not intended to affect existing agreements between service providers regarding how to "jurisdictionalize" traffic when traditional call identifying parameters are missing, as long as such agreements are not inconsistent with the rules adopted in this order.

331. We find that some very limited exceptions to these new rules are needed. We agree with Verizon, for example, that a limited exception is needed in situations where industry standards permit, or even require, some alteration in signaling information by an intermediate service provider.[867] As noted above, we do not intend to change standard industry practice with respect to the content of the signaling stream. Service providers that follow standard industry practice in this way will not be considered in violation of the prohibition on altering signaling information. We also note that the exemptions from our existing call signaling requirements described in section 64.1601(d) remain necessary for their limited purposes, and will continue to apply.[868]

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[867] *See* Verizon Phantom Traffic White Paper at 9-10. For example, Verizon states that on a call to a party that has forwarded its number, the called party's service provider will replace the caller's CN with the called party's CN before sending the call to the forward location.

[868] 47 C.F.R. § 64.1601(d).

b. Financial Responsibilities

332. We also impose financial responsibilities that will work in step with our amended signaling rules to give service providers financial incentives to ensure that they, and the providers whose traffic they carry, comply with the signaling obligations. We find that these requirements will significantly reduce any existing incentives to avoid compliance by substantially eliminating any financial benefits of noncompliance.

333. We agree with commenters who propose that we permit service providers that terminate traffic lacking sufficient information to bill the service provider that delivered the traffic to the terminating provider.[869] In particular, we require that a service provider, e.g., transit provider, delivering traffic that lacks any of the signaling information required by our rules as amended herein, or that does not otherwise provide the required call information, for example by providing an industry standard billing record, to the recipient, must pay the terminating service provider's highest termination rate in effect at the time the traffic is delivered to the terminating service provider.[870] By making intermediate service providers

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[869] *See, e.g.*, EPG Proposal at 2 ("All messages that are not properly labeled would be billed at the highest prevailing intercarrier compensation rate to the interconnecting carrier delivering the traffic."); ARIC Plan at 55; CenturyTel *ICC FNRPM* Comments at 6; Hickory *ICC FNPRM* Comments at 2; JSI *ICC FNPRM* Comments at 4-6; Colorado Telecom Ass'n et al. *ICC FNPRM* Reply at 13, TDS Telecom *ICC FNPRM* Reply 14, JSI *Missoula Phantom Traffic* Comments at 4-6; RICA *Missoula Phantom Traffic* Comments at 2-3; TexalTel *Missoula Phantom Traffic* Comments at 7-8; Cavalier *Missoula Phantom Traffic* Comments at 2-3; PAPUC *Missoula Phantom Traffic* Reply at 8.

[870] We agree with commenters who note that intermediate service providers that provide, to subsequent service providers in a call path,

financially responsible in these circumstances, we ensure that service providers are compensated for terminating traffic.

334. We also permit those intermediate service providers, in turn, to pass along the termination charges to the provider that delivered the applicable traffic to them, in addition to any otherwise-applicable charge for their services. We agree with commenters that the providers delivering traffic are in a better position than the terminating service provider "to know which carriers are routing improperly or incompletely identified traffic"[871] and to recover the termination charges from them. Moreover, by permitting intermediate service providers to pass along those charges on top of their otherwise-applicable rates, we create disincentives for service providers who might otherwise originate, or act as a "pass through" for mislabeled or unidentifiable traffic.

335. We are unpersuaded by the objections to imposing such financial obligations on intermediate service providers.[872] For example, one objection is based on the

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information sufficient to identify the provider that delivered the traffic to the intermediate provider should not be responsible for terminating intercarrier payments for that traffic. *See, e.g.*, Letter from Susanne A. Guyer, Senior Vice President—Federal Regulatory Affairs, Verizon, to Chairman Kevin Martin et al., FCC, CC Docket Nos. 96-45, 01-92 at 2 (filed Oct. 28, 2008); Letter from Mark D. Schneider, Counsel, Neutral Tandem, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008); Letter from Tamar E. Finn, Counsel, Zayo Group, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 2 (filed Oct. 28, 2008).

[871] ARIC Plan at 55.

[872] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 7, 2007); Letter from Charles W. McKee, Director—Government Affairs, Federal Regulatory, Sprint Nextel, to

assumption that transit providers will be the only intermediate service providers subject to such liability, and will be unable to pass along those charges.[873] The financial responsibility under this order for traffic that lacks sufficient billing information is not limited to transit service providers, however. Rather, any service provider that passes traffic lacking sufficient billing information becomes responsible for intercarrier payments to the receiving provider. Additionally, we expressly permit service providers subject to this charge to pass it along to the service provider that delivered the applicable traffic to them.

336. Another commenter objects to any proposal that "gives . . . [ILECs] the authority to impose new rates based on their own interpretation of the sufficiency of data received or interpretation of jurisdictional parameters."[874] Under our amended rules, service providers will not be able to impose rates based on their own interpretation of the sufficiency of data received. Instead, our amended rules set the standard for what information must be included and passed.

337. We also disagree with commenters who suggest that imposing liability on intermediate service providers implies that the problem is the result of transiting service providers altering call detail information.[875] The financial

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Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Apr. 20, 2007) (Sprint Nextel April 20, 2007 *Ex Parte* Letter); Letter from Charon Phillips, Director—Government Affairs, Federal Regulatory, Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 13, 2007).

[873] *See, e.g.*, Verizon *Missoula Phantom Traffic* Reply at 5-6.

[874] *See* Sprint Nextel April 20, 2007 *Ex Parte* Letter at 2.

[875] *See* Missoula Plan Supporters *Missoula Phantom Traffic* Reply at 11-12.

obligations we impose on intermediate service providers are triggered by passing traffic that does not comply with the call signaling rules, regardless of whether the traffic was originated or altered by the passing service provider. Accordingly, any service provider, not just a provider who stripped or altered traffic signaling, who is not taking steps to ensure that traffic carried on their network is properly labeled and identifiable could be held responsible for payment by the provider to whom it delivered traffic.

338. In addition to call signaling, the USTelecom Feb. 12, 2008 proposal seeks Commission action related to routing traffic, local number portability queries, and providing incumbent LECs with certain rights with regard to the section 251 and 252 negotiation and arbitration processes.[876] Although a broad cross section of the industry supports the USTelecom Feb. 12, 2008 proposal in its entirety, several commenters objected to the section 251 and 252 negotiation and arbitration provisions.[877] In light of the lack of consensus on some of these issues

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[876] *See* USTA Feb. 12, 2008 Proposal.

[877] *See, e.g.*, Letter from Brad Mutschelknaus, Counsel to Broadview Networks et al. to Kevin J. Martin et al., FCC, CC Docket No. 01-92 (filed Oct. 22, 2008); Letter from Henry T. Kelly, Counsel to Peerless Networks to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92 et al. (filed Sept. 16, 2008); Letter from Charles W. McKee, Director—Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 16, 2008); Letter from Thomas Cohen, Edward A. Yorkgitis, Jr., Counsel for NuVox Communications et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 11, 2008); Letter from Daniel L. Brenner, Senior Vice President, Law and Regulatory Policy, NCTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 29, 2008); Letter from Paul Garnett, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 25, 2008).

and the changes to the intercarrier compensation system adopted in this order we are not persuaded that the other specific actions sought in the USTelecom Feb 12, 2008 proposal are necessary at this time.[878]

VI. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Universal Service

339. In the above order, we adopted a five year plan for phasing out current competitive ETC support. Here we seek comment on an appropriate universal service mechanism (or mechanisms) focused on the deployment and maintenance of advanced mobile wireless services in high-cost and rural areas.

340. With respect to contribution methodology, as we explain above, an assessment methodology based solely on telephone numbers would not require certain business services to equitably contribute to the universal service fund.[879] We, therefore, determine that universal service contributions for business services will be based on connections as opposed to numbers. We seek comment on how best to implement a connection-based mechanism for business services, and whether that mechanism should be based solely on connections or on a combination of Assessable Numbers and connections.

341. We also seek comment on expanding our NRUF data collection to all providers who are required to con-

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[878] The USTA Feb 12, 2008 Proposal also sought certain enforcement commitments related to our call signaling rules. In this regard, USTA's proposal did not seek anything beyond the ordinary course of business. As with any of our rules, the Commission is committed to resolving complaints expeditiously and will not hesitate to initiate enforcement proceedings against rule violators.

[879] *See supra* para. 130.

tribute to the universal service fund based on Assessable Numbers. At present, our NRUF reporting rules require "reporting carriers" to file reports. A "reporting carrier" is defined as "a telecommunications carrier that receives numbering resources from the NANPA, a Pooling Administrator or another telecommunications carrier."[880] "Reporting carriers" file reports regarding six categories of numbers, the descriptions of some of which refer to "telecommunications carriers" or "telecommunications services."[881] We seek comment on whether we should amend our rules to require all providers who assign numbers or otherwise make numbers available to end users to file NRUF reports. Would such an expansion assist the Commission and the fund administrator with monitoring and enforcing universal service contribution requirements? What modifications would the Commission need to make to its rules to effectuate this kind of policy change?

B. Intercarrier Compensation Further Notice

342. In this Further Notice of Proposed Rulemaking (Further Notice) we seek comment on certain additional issues not resolved in our accompanying order.

343. *Originating Access.* In this order, we conclude that retention of originating access charges would be inconsistent with our new regulatory approach to intercarrier compensation.[882] Accordingly, we find that originating charges for all telecommunications traffic subject to

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[880] 47 C.F.R. § 52.12(f)(2).

[881] *E.g.*, 47 C.F.R. § 52.12(e)(i) ("*Administrative numbers* are numbers used by telecommunications carriers . . . ."); *id.* § 52.12(e)(v) ("*Intermediate numbers* are numbers that are made available . . . for the purpose of providing telecommunications service . . . .").

[882] *See supra* para. 229.

our comprehensive intercarrier compensation framework must be eliminated by the conclusion of the transition to the new regime. We seek comment on issues relating to the transition for the elimination of originating access.

344. *Transit Traffic.* Transiting occurs when two carriers that are not directly interconnected exchange traffic by routing the traffic through an intermediary carrier's network.[683] We request comment on whether the reforms we adopt today necessitate the adoption of any rules or guidelines governing transit service.

345. *Universal Service Rules Applicable to Rate-of-Return Carriers.* In this order, we conclude that under certain circumstances, rate-of-return carriers will be able to receive universal service support to recover net reduced revenues from intercarrier compensation as a result of reforms adopted in this order that they do not otherwise recover through SLC increases or other revenue increases. We seek comment on what rule changes are necessary to allow rate of-return carriers to receive universal service support in this manner.

346. *Parts 51, 54, 61 and 69.* Part 51 of the Commission's rules contain requirements applicable to interconnection, including reciprocal compensation.[684] Part 54 of the Commission's rules describe universal service programs and administration.[685] Part 61 of the Commission's

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[683] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4737-38, para. 120. Typically, the intermediary carrier is an incumbent LEC and the transited traffic is routed from the originating carrier through the incumbent LEC's tandem switch to the terminating carrier. The intermediary (transiting) carrier then charges a fee for use of its facilities. *See id.* We note that carriers have various agreements governing the provision of transit traffic. *See id.*

[684] *See* 47 C.F.R. Part 51.

[685] *See* 47 C.F.R. Part 54.

rules prescribes the framework for the initial establishment of and subsequent revisions to tariff publications.[886] Part 69 of the rules governs the Commission's access charge regulations for interstate or foreign access services.[887] We solicit comment on the need to revise the rules set forth in Parts 51, 54, 61 and/or 69, or any other rules, as a result of the reforms we adopt today.

VII. PROCEDURAL MATTERS

A. *Ex Parte* Presentations

347. The rulemaking this Further Notice initiates shall be treated as a "permit-but-disclose" proceeding in accordance with the Commission's ex parte rules.[888] Persons making oral ex parte presentations are reminded that memoranda summarizing the presentations must contain summaries of the substance of the presentations and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and arguments presented generally is required.[889] Other requirements pertaining to oral and written presentations are set forth in section 1. 1206(b) of the Commission's rules.[890]

B. Comment Filing Procedures

348. Pursuant to sections 1.415 and 1.419 of the Commission's rules,[891] interested parties may file comments and reply comments regarding the Further Notice on or before the dates indicated on the first page of this document. **All filings related to the intercarrier compensa-**

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[886] *See* 47 C.F.R. Part 61.

[887] *See* 47 C.F.R. Part 69.

[888] 47 C.F.R. § 1.200 *et seq.*

[889] *See* 47 C.F.R. § 1.1206(b)(2).

[890] 47 C.F.R. § 1.1206(b).

[891] 47 C.F.R. §§ 1.415, 1.419.

tion Further Notice of Proposed Rulemaking should refer to CC Docket No. 01-92. All filings related to the universal service contributions Further Notice of Proposed Rulemaking should refer to WC Docket No. 06-122. Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's e-Rulemaking Portal, or (3) by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 FR 24121 (1998).

349. Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal e-Rulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

350. ECFS filers must transmit one electronic copy of the comments for CC Docket Nos. 01-92, 99-200, or WC Docket No. 06-122, respectively. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

351. Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal

Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554.

352. The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

353. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

354. U.S. Postal Service first-class, Express, and Priority mail should be addressed to 445 12th Street, S.W., Washington D.C. 20554.

355. Parties should send a copy of their filings in CC Docket No. 01-92 to Victoria Goldberg, Pricing Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A266, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

356. Parties should send a copy of their filings in WC Docket No. 06-122 to Jennifer McKee, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve

one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

357. Parties should send a copy of their filings in WC Docket No. 99-200 to Marilyn Jones, Competition Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies @fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

358. Documents in CC Docket Nos. 01-92, 99-200, and WC Docket No. 06-122 will be available for public inspection and copying during business hours at the FCC Reference Information Center, Portals II, 445 12th Street S.W., Room CY-A257, Washington, D.C. 20554. The documents may also be purchased from BCPI, telephone (202) 488-5300, facsimile (202) 488-5563, TTY (202) 488-5562, e-mail fcc@bcpiweb.com.

C. Initial Regulatory Flexibility Analysis

359. As required by the Regulatory Flexibility Act of 1980,[882] the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the policies and rules addressed in this document. The IRFA is set forth in Appendix [[_]]. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines

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[882] *See* 5 U.S.C. § 603.

for comments on the Notice provided on or before the dates indicated on the first page of this Notice.

D. Final Regulatory Flexibility Analysis

360. Pursuant to the Regulatory Flexibility Act (RFA),[883] the Commission has prepared a Final Regulatory Flexibility Analysis (FRFA) for the Report and Order concerning the possible significant economic impact on small entities by the policies and actions considered in the Report and Order. The text of the FRFA is included in Appendix [[__]].

E. Paperwork Reduction Act

361. This document contains proposed new or modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198,[884] we seek specific comment on how we might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

F. Accessible Formats

362. To request materials in accessible formats for people with disabilities (Braille, large print, electronic

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[883] *See* 5 U.S.C. § 603. The RFA, *see* U.S.C. § 601 *et seq.*, has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) ("CWAAA"). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 ("Small Business Act").

[884] *See* 44 U.S.C. § 3506(c)(4).

files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice) or 202-418-0432 (TTY). Contact the FCC to request reasonable accommodations for filing comments (accessible format documents, sign language interpreters, CART, etc.) by e-mail: FCC504@fcc.gov; phone: 202-418-0530 or TTY: 202-418-0432.

G. Congressional Review Act

363. The Commission will include a copy of this Order on Remand and Report and Order and Further Notice of Proposed Rulemaking in a report to be sent to Congress and the Government Accountability Office pursuant to the Congressional Review Act. See 5 U.S.C. § 801(a)(1)(A).

VIII. ORDERING CLAUSES

364. Accordingly, IT IS ORDERED that, pursuant to Sections 1-4, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, and 503 of the Communications Act of 1934, as amended, and Sections 601 and 706 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 157 nt, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, 503, and sections 1.1, 1.411-1.429, and 1.1200-1.1216 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.411-1.429, 1.1200-1.1216, the ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING ARE ADOPTED.

365. IT IS FURTHER ORDERED that Parts [[__]] of the Commission's rules, 47 C.F.R. § [[__]] are AMENDED as set forth in Appendix A hereto.

366. IT IS FURTHER ORDERED, in light of the opinion of the United States Court of Appeals for the District of Columbia Circuit in *WorldCom v. FCC*, 288

F.3d 429 (D.C. Cir. 2002), we consider our obligations met from the writ of mandamus issued in *In re Core Communications, Inc. on Petition for Writ of Mandamus to the Federal Communications Commission*, D.C. Cir. No. 07-1446 (decided July 8, 2008).

367. IT IS FURTHER ORDERED that this ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING shall become effective 30 days after publication of the text of a summary thereof in the Federal Register, pursuant to 47 C.F.R. §§ 1.4, 1.13, except for the information collections, which require approval by OMB under the PRA and which shall become effective after the Commission publishes a notice in the Federal Register announcing such approval and the relevant effective date(s).

368. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this REPORT AND ORDER AND ORDER ON REMAND, including the Final Regulatory Flexibility Analyses and Final Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

369. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this FURTHER NOTICE OF PROPOSED RULEMAKING, including the Initial Regulatory Flexibility Analyses and Initial Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

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FEDERAL COMMUNICATIONS COMMISSION
FCC 08-262

APPENDIX E
INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

1. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),[1] the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on a substantial number of small entities by the policies and rules proposed in this Further Notice. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Further Notice. The Commission will send a copy of the Further Notice, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).[2] In addition, the Further Notice and IRFA (or summaries thereof) will be published in the Federal Register.[3]

A. Need for, and Objectives of, the Proposed Rules

2. Today, the Commission adopts a Further Notice on possible steps for the implementation of universal service and intercarrier compensation comprehensive reform. We believe it is best to leave the following topics to a Further Notice to help ensure the development of a reasoned and complete record on the issues.

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[1] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601-612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

[2] *See* 5 U.S.C. § 603(a).

[3] *See id.*

3. Specifically, the Commission seeks comment on the appropriate, applicable cost standard under section 252(d)(2) of the Act. We seek comment on whether comprehensive reform for intercarrier compensation should apply to providers operating in Alaska, Hawaii, or any U.S. Territory or possession. Additionally, we seek comment on how carriers' current rates should be transitioned to a new intercarrier compensation regime. Also, we seek comment on whether the Commission should set any conditions on the reciprocal compensation rates set by states. Should any transitional rates apply to VoIP traffic?

4. We also seek comment on the appropriate default rules regarding where a carriers' "network edge" should be following any transition. The Further Notice also seeks comment on whether the reciprocal compensation rates between carriers should be symmetrical without exception and regardless of whether traffic exchanged between the carriers is balanced or not. In addition, we seek comment on the appropriate guidelines regarding the application of section 251(f)(2) of the Act.

5. We seek comment on the appropriate treatment of existing agreements between parties. We also seek comment on various revenue recovery opportunities for carriers and possible supplemental universal service recovery support that would be available where necessary. Should the Commission also require carriers to file an annual report showing how any net access savings are allocated? We also seek comment on whether or not the Commission should enlist the aid of the Separations Joint Board on possible changes to end-user charges.

6. The Further Notice also seeks comment on measures to ensure the ability of carriers to receive the appropriate compensation for traffic terminated on their

networks. We also seek comment on an interim solution to the "access stimulation" arbitrage problem. Additionally, we seek comment on whether originating access charges are inconsistent with comprehensive reform and the appropriate transition for the elimination of originating access. We also seek comment on whether or not any comprehensive reform warrants the adoption of rules or guidelines governing the terms and conditions of transit service.

7. We also seek comment on how best to reform the distribution of high-cost universal service support. Specifically, we seek comment on ways to control the growth of the high-cost fund, including whether it is necessary to cap high-cost universal service support to fulfill our statutory obligation to create a specific, predictable, and sufficient universal service mechanism. We seek comment on how any such caps should be implemented. We seek comment on whether we should condition receipt of high-cost support on an eligible telecommunications carrier's (ETC) commitment to provide broadband Internet access service throughout its service area. We seek comment on the use of reverse auctions as a method for disbursing high-cost support, either to areas where an incumbent LEC does not commit to provide broadband Internet access service, or for the distribution of high-cost support to all ETCs. We seek comment on eliminating the identical support rule for competitive ETCs, and on whether competitive ETC support should be based on their own costs or disbursed via reverse auctions.

8. We seek comment on whether to adopt a pilot program to provide universal service support to low-income consumers for broadband Internet access service. Should low-income consumers receive support under the pilot program for discounts on broadband Internet access

service and devices necessary to access such services? What implementation and reporting requirements associated with such a pilot program should the Commission adopt?

9. We also seek comment on reforming the universal service contribution assessment methodology. Specifically, we seek comment on whether to adopt a contribution mechanism of $1.00 per residential telephone number, and move to a connections and/or numbers-based contribution mechanism for business services; or whether to adopt a contribution mechanism of $0.85 per telephone number for all numbers, and a connections-based contribution mechanism for business services of $5.00 per connection up to 64 kbps and $35.00 per connection over 64 kbps. We seek comment on what numbers should be assessable under a numbers-based contribution mechanism. We also seek comment on how to treat wireless prepaid plans, on exceptions to the contribution obligations, on reporting and recordkeeping requirements, and on a transition to the new contribution methodology.

10. Finally, we seek comment on what revisions to our rules are needed to implement comprehensive reform. For example, what changes, if any, are needed to the rules contained in Parts 51, 54, 61, and 69?

B. Legal Basis

11. The legal basis for any action that may be taken pursuant to the Further Notice is contained in sections 1-4, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, 503 of the Communications Act of 1934, as amended, and Sections 601 and 706 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 157 nt, 201-209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, 503 and sections 1.1, 1.411-1.429 and 1.1200-1.1216 of the

Commission's rules, 47 C.F.R. §§ 1.1, 1.411-1.429 and 1.1200-1.1216.

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

12. The RFA directs agencies to provide a description of, and where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[4] The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[5] In addition, the term "small business" has the same meaning as the term "small-business concern" under the Small Business Act.[6] A small-business concern" is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration.[7]

13. **Wired Telecommunications Carriers.** The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such

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[4] *See* 5 U.S.C. § 603(b)(3).

[5] *See* 5 U.S.C. § 601(6).

[6] *See* 5 U.S.C. § 601(3) (incorporating by reference the definition of "small-business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

[7] *See* 15 U.S.C. § 632.

companies having 1,500 or fewer employees.[8] According to Census Bureau data for 2002, there were 2,432 firms in this category, total, that operated for the entire year.[9] Of this total, 2,395 firms had employment of 999 or fewer employees, and an additional 37 firms had employment of 1,000 employees or more.[10] Thus, under this size standard, the majority of firms can be considered small.

14. **Local Exchange Carriers (LECs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[11] According to Commission data, 1,311 carriers reported that they were incumbent local exchange service providers.[12] Of these 1,311 carriers, an estimated 1,024 have 1,500 or fewer employees and 287 have more than 1,500 employees.[13] Consequently, the Commission estimates that most providers of local exchange service are small entities that may be affected by the rules and policies proposed in the Further Notice.

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[8] 13 C.F.R. § 121.201, U.S. Census Bureau, 2002 Economic Census, Subject Series: Information, "Establishment and Firm Size (Including Legal Form of Organization)," North American Industry Classification System (NAICS) code 517110.

[9] 13 C.F.R. § 121.201, NAICS code 517110.

[10] *See id.*

[11] 13 C.F.R. § 121.201, NAICS code 517110.

[12] *See Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division at Table 5.3 (Aug. 2008) (*Trends in Telephone Service*).

[13] *See id.*

15. **Incumbent Local Exchange Carriers (incumbent LECs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to incumbent local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[14] According to Commission data, 1,311 carriers reported that they were engaged in the provision of local exchange services.[15] Of these 1,307 carriers, an estimated 1,024 have 1,500 or fewer employees and 287 have more than 1,500 employees.[16] Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by rules adopted pursuant to the Further Notice.

16. We have included small incumbent LECs in this present RFA analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (e.g., a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[17] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not "national" in scope.[18] We have therefore included small in-

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[14] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[15] *See Trends in Telephone Service* at Table 5.3.

[16] *See id.*

[17] 5 U.S.C. § 601(3).

[18] *See* Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small busi-

cumbent LECs in this RFA analysis, although we emphasize that this RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

17. **Competitive Local Exchange Carriers (competitive LECs), Competitive Access Providers (CAPs), Shared-Tenant Service Providers, and Other Local Service Providers.** Neither the Commission nor the SBA has developed a small business size standard specifically for these service providers. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[19] According to Commission data, 1,005 carriers reported that they were engaged in the provision of either competitive local exchange services or competitive access provider services.[20] Of these 1,005 carriers, an estimated 918 have 1,500 or fewer employees and 87 have more than 1,500 employees.[21] In addition, 16 carriers have reported that they are Shared-Tenant Service Providers, and all 16 are estimated to have 1,500 or fewer employees.[22] In addition, 89 carriers have reported that they are Other Local Service Providers.[23] Of the 89, all 89 have 1,500 or fewer employees and none has more than 1,500 employees.[24] Consequently, the Commission estimates that most providers of competitive local exchange ser-

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ness." *See* 15 U.S.C. § 632(a); *see also* 5 U.S.C. § 601(3). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. *See* 13 C.F.R. § 121.102(b).

[19] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[20] *See Trends in Telephone Service* at Table 5.3.

[21] *See id.*

[22] *See id.*

[23] *See id.*

[24] *See id.*

vice, competitive access providers, Shared-Tenant Service Providers, and Other Local Service Providers are small entities that may be affected by rules adopted pursuant to the Further Notice.

18. **Interexchange Carriers (IXCs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to interexchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[25] According to Commission data, 300 companies reported that their primary telecommunications service activity was the provision of interexchange services.[26] Of these 300 companies, an estimated 268 have 1,500 or fewer employees and 32 have more than 1,500 employees.[27] Consequently, the Commission estimates that the majority of interexchange service providers are small entities that may be affected by rules adopted pursuant to the Further Notice.

19. **Operator Service Providers (OSPs).** Neither the Commission nor the SBA has developed a small business size standard specifically for operator service providers. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[28] According to Commission data, 28 carriers have reported that they are engaged in the provision of operator services.[29] Of these, an

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[25] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[26] *See Trends in Telephone Service* at Table 5.3.

[27] *See id.*

[28] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[29] *See Trends in Telephone Service* at Table 5.3.

estimated 27 have 1,500 or fewer employees and one has more than 1,500 employees.[30] Consequently, the Commission estimates that the majority of OSPs are small entities that may be affected by rules adopted pursuant to the Further Notice.

20. **Payphone Service Providers (PSPs).** Neither the Commission nor the SBA has developed a small business size standard specifically for payphone services providers. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[31] According to Commission data, 526 carriers have reported that they are engaged in the provision of payphone services.[32] Of these, an estimated 524 have 1,500 or fewer employees and two have more than 1,500 employees.[33] Consequently, the Commission estimates that the majority of payphone service providers are small entities that may be affected by rules adopted pursuant to the Further Notice.

21. **Prepaid Calling Card Providers.** Neither the Commission nor the SBA has developed a small business size standard specifically for prepaid calling card providers. The appropriate size standard under SBA rules is for the category Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[34] According to Commission data, 88 carriers have reported that they are engaged in the pro-

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[30] *See id.*

[31] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[32] *See Trends in Telephone Service* at Table 5.3.

[33] *See id.*

[34] *See* 13 C.F.R. § 121.201, NAICS code 517911.

vision of prepaid calling cards.[35] Of these, an estimated 85 have 1,500 or fewer employees and three have more than 1,500 employees.[36] Consequently, the Commission estimates that the majority of prepaid calling card providers are small entities that may be affected by rules adopted pursuant to the Further Notice.

22. **Local Resellers.** The SBA has developed a small business size standard for the category of Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[37] According to Commission data, 151 carriers have reported that they are engaged in the provision of local resale services.[38] Of these, an estimated 149 have 1,500 or fewer employees and two have more than 1,500 employees.[39] Consequently, the Commission estimates that the majority of local resellers are small entities that may be affected by rules adopted pursuant to the Further Notice.

23. **Toll Resellers.** The SBA has developed a small business size standard for the category of Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[40] According to Commission data, 815 carriers have reported that they are engaged in the provision of toll resale services.[41] Of these, an estimated 787 have 1,500 or fewer employees and 28 have more than 1,500 employees.[42] Consequently,

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[35] *See Trends in Telephone Service* at Table 5.3.

[36] *See id.*

[37] *See* 13 C.F.R. § 121.201, NAICS code 517911.

[38] *See Trends in Telephone Service* at Table 5.3.

[39] *See id.*

[40] *See* 13 C.F.R. § 121.201, NAICS code 517911.

[41] *See Trends in Telephone Service* at Table 5.3.

[42] *See id.*

the Commission estimates that the majority of toll resellers are small entities that may be affected by rules adopted pursuant to the Further Notice.

24. **Other Toll Carriers.** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to Other Toll Carriers. This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[43] According to Commission data, 91 companies reported that their primary telecommunications service activity was the provision of other toll carriage.[44] Of these 91 companies, an estimated 88 have 1,500 or fewer employees and three have more than 1,500 employees.[45] Consequently, the Commission estimates that most Other Toll Carriers are small entities that may be affected by the rules and policies adopted pursuant to the Further Notice.

25. **800 and 800-Like Service Subscribers.**[46] Neither the Commission nor the SBA has developed a small business size standard specifically for 800 and 800-like service (toll free) subscribers. The appropriate size standard under SBA rules is for the category Telecommunications Resellers. Under that size standard, such a busi-

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[43] *See* 13 C.F.R. § 121.201, NAICS code 517110.

[44] *See Trends in Telephone Service* at Table 5.3.

[45] *See id.*

[46] We include all toll-free number subscribers in this category, including those for 888 numbers.

ness is small if it has 1,500 or fewer employees.[47] The most reliable source of information regarding the number of these service subscribers appears to be data the Commission collects on the 800, 888, 877, and 866 numbers in use.[48] According to our data, at the beginning of December 2007, the number of 800 numbers assigned was 7,860,000; the number of 888 numbers assigned was 5,210,184; the number of 877 numbers assigned was 4,388,682; and the number of 866 numbers assigned was 7,029,116.[49] We do not have data specifying the number of these subscribers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of toll free subscribers that would qualify as small businesses under the SBA size standard. Consequently, we estimate that there are 7,860,000 or fewer small entity 800 subscribers; 5,210,184 or fewer small entity 888 subscribers; 4,388,682 or fewer small entity 877 subscribers; and 7,029,166 or fewer small entity 866 subscribers.

1. Wireless Carriers and Service Providers

26. Below, for those services subject to auctions, we note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments or transfers, unjust enrichment issues are implicated.

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[47] *See* 13 C.F.R. § 121.201, NAICS code 517911.

[48] *See Trends in Telephone Service* at Tables 18.4, 18.5, 18.6, 18.7.

[49] *See id.*

27. **Wireless Telecommunications Carriers (except Satellite).** Since 2007, the SBA has recognized wireless firms within this new, broad, economic census category.[50] Prior to that time, the SBA had developed a small business size standard for wireless firms within the now-superseded census categories of Paging and Cellular and Other Wireless Telecommunications.[51] Under the present and prior categories, the SBA has deemed a wireless business to be small if it has 1,500 or fewer employees. Because Census Bureau data are not yet available for the new category, we will estimate small business prevalence using the prior categories and associated data. For the first category of Paging, data for 2002 show that there were 807 firms that operated for the entire year.[52] Of this total, 804 firms had employment of 999 or fewer employees, and three firms had employment of 1,000 employees or more.[53] For the second category of Cellular and Other Wireless Telecommunications, data for 2002 show that there were 1,397 firms that operated for the entire year.[54] Of this total, 1,378 firms had employment of 999 or fewer employees, and 19 firms had employment of 1,000 employees or more.[55] Thus, using the prior categories and

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[50] *See* 13 C.F.R. § 121.201, NAICS code 517210. 2007 Census data are not yet available.

[51] *See* 13 C.F.R. § 121.201, NAICS codes 517211, 517212.

[52] *See* 13 C.F.R. § 121.201, NAICS code 517211.

[53] *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is for firms with "1,000 employees or more."

[54] *See* 13 C.F.R. § 121.201, NAICS code 517212.

[55] *See id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is for firms with "1,000 employees or more."

the available data, we estimate that the majority of wireless firms can be considered small. According to Commission data, 434 carriers reported that they were engaged in the provision of cellular service, Personal Communications Service (PCS), or Specialized Mobile Radio (SMR) Telephony services, which are placed together in the data.[56] We have estimated that 222 of these are small, under the SBA small business size standard.[57] Thus, under this category and size standard, approximately half of firms can be considered small.

28. **Broadband Personal Communications Service.** The broadband personal communications service (PCS) spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission defined "small entity" for Blocks C and F as an entity that has average gross revenues of $40 million or less in the three previous calendar years.[58] For Block F, an additional classification for "very small business" was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years.[59] These standards defining "small entity" in the context of broadband PCS auctions have

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[56] *See Trends in Telephone Service* at Table 5.3.

[57] *See id.*

[58] *See generally Amendment of Parts 20 and 24 of the Commission's Rules—Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, GN Docket No. 90-314, Report and Order, 11 FCC Rcd 7824 (1996); *see also* 47 C.F.R. § 24.720(b)(1).

[59] *See generally Amendment of Parts 20 and 24 of the Commission's Rules—Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, GN Docket No. 90-314, Report and Order, 11 FCC Rcd 7824 (1996); *see also* 47 C.F.R. § 24.720(b)(2).

been approved by the SBA.[60] No small businesses, within the SBA-approved small business size standards bid successfully for licenses in Blocks A and B. There were 90 winning bidders that qualified as small entities in the Block C auctions. A total of 93 small and very small business bidders won approximately 40 percent of the 1,479 licenses for Blocks D, E, and F.[61] On March 23, 1999, the Commission re-auctioned 347 C, D, E, and F Block licenses. There were 48 small business winning bidders. On January 26, 2001, the Commission completed the auction of 422 C and F Broadband PCS licenses in Auction No. 35. Of the 35 winning bidders in that auction, 29 qualified as "small" or "very small" businesses. Subsequent events, concerning Auction 35, including judicial and agency determinations, resulted in a total of 163 C and F Block licenses being available for grant.

29. **Narrowband Personal Communications Services**. To date, two auctions of narrowband PCS licenses have been conducted. For purposes of the two auctions that have been held, "small businesses" were entities with average gross revenues for the prior three calendar years of $40 million or less. Through these auctions, the Commission has awarded a total of 41 licenses, out of which 11 were obtained by small businesses. To ensure meaningful participation of small business entities in fu-

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[60] *See, e.g., Implementation of Section 309(j) of the Communications Act—Competitive Bidding*, PP Docket No. 93-253, Fifth Report and Order, 9 FCC Rcd 5532 (1994).

[61] *See* FCC News, Broadband PCS, D, E and F Block Auction Closes, No. 71744 (rel. Jan. 14, 1997). *See also Amendment of the Commission's Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licensees*, WT Docket No. 97-82, Second Report and Order and Further Notice of Proposed Rulemaking, 12 FCC Rcd 16436 (1997).

ture auctions, the Commission has adopted a two-tiered small business size standard in the *Narrowband PCS Second Report and Order*.[62] A "small business" is an entity that, together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than $40 million. A "very small business" is an entity that, together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than $15 million. The SBA has approved these small business size standards.[63] In the future, the Commission will auction 459 licenses to serve Metropolitan Trading Areas (MTAs) and 408 response channel licenses. There is also one megahertz of narrowband PCS spectrum that has been held in reserve and that the Commission has not yet decided to release for licensing. The Commission cannot predict accurately the number of licenses that will be awarded to small entities in future actions. However, four of the 16 winning bidders in the two previous narrowband PCS auctions were small businesses, as that term was defined under the Commission's rules.[64] The Commission assumes, for purposes of this analysis that a large portion of the remaining narrowband PCS licenses will be awarded to small entities. The Commission also assumes that at least some small businesses will acquire narrowband

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[62] *See generally Amendment of the Commission's Rules to Establish New Personal Communications Services, Narrowband PCS*, GEN Docket No. 90-314, ET Docket No. 92-100, PP Docket No. 93-253, Second Report and Order and Second Further Notice of Proposed Rulemaking, 15 FCC Rcd 10456 (2000).

[63] *See* Letter to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Dec. 2, 1998).

[64] *See* 47 C.F.R. § 24.321(a).

PCS licenses by means of the Commission's partitioning and disaggregation rules.

30. **Paging (Private and Common Carrier).** The SBA has developed a small business size standard for Paging, under which a business is small if it has 1,500 or fewer employees.[65] In addition, in the *Paging Third Report and Order*, we developed a small business size standard for "small businesses" and "very small businesses" for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.[66] A "small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $15 million for the preceding three years. Additionally, a "very small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $3 million for the preceding three years.[67] The SBA has approved these small business size standards.[68] According to Commission data, 281 carriers have reported

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[65] *See* 13 C.F.R. § 121.201, NAICS code 517211 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

[66] *See Amendment of Part 90 of the Commission's Rules to Provide for the Use of the 220-222 MHz Band by the Private Land Mobile Radio Service*, PR Docket No. 89-552, GN Docket No. 93-252, PP Docket No. 93-253, Third Report and Order and Fifth Notice of Proposed Rulemaking, 12 FCC Rcd 10943, 11068-70, paras. 291-295 (1997) (*220 MHz Third Report and Order*).

[67] *See* Letter to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from A. Alvarez, Administrator, SBA (Dec. 2, 1998).

[68] *See Revision of Part 22 and Part 90 of the Commission's Rules to Facilitate Future Development of Paging Systems*, WT Docket No. 96-18, PR Docket No. 93-253, Memorandum Opinion and Order on Reconsideration and Third Report and Order, 14 FCC Rcd 10030, 10085-88, paras. 98-107 (1999) (*Paging Third Report and Order*).

that they are engaged in Paging or Messaging Service.[69] Of these, an estimated 279 have 1,500 or fewer employees, and two have more than 1,500 employees.[70] Consequently, the Commission estimates that the majority of paging providers are small entities that may be affected by our action. An auction of Metropolitan Economic Area licenses commenced on February 24, 2000, and closed on March 2, 2000. Of the 985 licenses auctioned, 440 were sold. Fifty-seven companies claiming small business status won.

31. **Wireless Telephony**. Wireless telephony includes cellular, PCS, and specialized mobile radio (SMR) telephony carriers. As noted earlier, the SBA has developed a small business size standard for Cellular and Other Wireless Telecommunications services.[71] Under that SBA small business size standard, a business is small if it has 1,500 or fewer employees.[72] According to Commission data, 434 carriers reported that they were engaged in the provision of wireless telephony.[73] We have estimated that 222 of these are small under the SBA small business size standard.[74]

32. **220 MHz Radio Service—Phase I Licensees**. The 220 MHz service has both Phase I and Phase II licenses. Phase I licensing was conducted by lotteries in 1992 and 1993. There are approximately 1,515 such non-

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[69] *See Trends in Telephone Service* at Table 5.3.

[70] *See id.*

[71] *See* 13 C.F.R. § 121.201, NAICS code 517212. (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517201.).

[72] *See id.*

[73] *See Trends in Telephone Service* at Table 5.3.

[74] *See id.*

nationwide licensees and four nationwide licensees currently authorized to operate in the 220 MHz band. The Commission has not developed a small business size standard for small entities specifically applicable to such incumbent 220 MHz Phase I licensees. To estimate the number of such licensees that are small businesses, we apply the small business size standard under the SBA rules applicable to Cellular and Other Wireless Telecommunications companies. Under this category, the SBA deems a wireless business to be small if it has 1,500 or fewer employees.[76] The Commission estimates that nearly all such licensees are small businesses under the SBA's small business size standard that may be affected by rules adopted pursuant to the Further Notice.

33. **220 MHz Radio Service—Phase II Licensees.** The 220 MHz service has both Phase I and Phase II licenses. The Phase II 220 MHz service is a new service, and is subject to spectrum auctions. In the *220 MHz Third Report and Order*, we adopted a small business size standard for "small" and "very small" businesses for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.[78] This small business size standard indicates that a "small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $15 million for the preceding three years.[77] A "very small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues that do not exceed $3 million for the preceding

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[76] *See* 13 C.F.R. § 121.201, NAICS code 517212.

[78] *See 220 MHz Third Report and Order*, 12 FCC Rcd at 11068-70, at paras. 291-95.

[77] *See id.* at 11068-69, para. 291.

three years.[78] The SBA has approved these small business size standards.[79] Auctions of Phase II licenses commenced on September 15, 1998, and closed on October 22, 1998.[80] In the first auction, 908 licenses were auctioned in three different-sized geographic areas: three nationwide licenses, 30 Regional Economic Area Group (EAG) Licenses, and 875 Economic Area (EA) Licenses. Of the 908 licenses auctioned, 693 were sold. Thirty-nine small businesses won licenses in the first 220 MHz auction. The second auction included 225 licenses: 216 EA licenses and 9 EAG licenses. Fourteen companies claiming small business status won 158 licenses.[81]

34. **800 MIIz and 900 MHz Specialized Mobile Radio Licenses.** The Commission awards "small entity" and "very small entity" bidding credits in auctions for Specialized Mobile Radio (SMR) geographic area licenses in the 800 MHz and 900 MIIz bands to firms that had revenues of no more than $15 million in each of the three previous calendar years, or that had revenues of no more than $3 million in each of the previous calendar years, respectively.[82] These bidding credits apply to SMR providers in the 800 MHz and 900 MHz bands that either hold geographic area licenses or have obtained extended implementation authorizations. The Commission does not know how many firms provide 800 MHz or 900 MHz geographic area SMR service pursuant to extended im-

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[78] *See id.* at 11068-70, paras. 291-95.

[79] *See* Letter to D. Phythyon, Chief, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Jan. 6, 1998).

[80] *See Phase II 220 MHz Service Auction Closes*, Public Notice, 14 FCC Rcd 605 (1998).

[81] *See Phase II 220 MHz Service Spectrum Auction Closes*, Public Notice, 14 FCC Rcd 11218 (1999).

[82] *See* 47 C.F.R. § 90.814(b).

plementation authorizations, nor how many of these providers have annual revenues of no more than $15 million. One firm has over $15 million in revenues. The Commission assumes, for purposes here, that all of the remaining existing extended implementation authorizations are held by small entities, as that term is defined by the SBA. The Commission has held auctions for geographic area licenses in the 800 MHz and 900 MHz SMR bands. There were 60 winning bidders that qualified as small or very small entities in the 900 MHz SMR auctions. Of the 1,020 licenses won in the 900 MHz auction, bidders qualifying as small or very small entities won 263 licenses. In the 800 MIIz auction, 38 of the 524 licenses won were won by small and very small entities.

35. **700 MHz Guard Band Licensees.** In the *700 MHz Guard Band Order*, we adopted a small business size standard for "small businesses" and "very small businesses" for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.[83] A "small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $40 million for the preceding three years.[84] Additionally, a "very small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $15 million for the preceding three years.[85] An auction of 52 Major Economic Area (MEA) licenses commenced on September 6, 2000, and closed on

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[83] *See Service Rules for the 746-764 and 776-794 MHz Bands, and Revisions to Part 27 of the Commission's Rules*, WT Docket No. 99-168, Second Report and Order, 15 FCC Rcd 5299 (2000) (*700 MHz Guard Band Order*).

[84] *See id.* at 5343-45 paras. 106-10.

[85] *See id.*

September 21, 2000.[86] Of the 104 licenses auctioned, 96 licenses were sold to nine bidders. Five of these bidders were small businesses that won a total of 26 licenses. A second auction of 700 MHz Guard Band licenses commenced on February 13, 2001 and closed on February 21, 2001. All eight of the licenses auctioned were sold to three bidders. One of these bidders was a small business that won a total of two licenses.[87]

36. **Rural Radiotelephone Service**. The Commission has not adopted a size standard for small businesses specific to the Rural Radiotelephone Service.[88] A significant subset of the Rural Radiotelephone Service is the Basic Exchange Telephone Radio System (BETRS).[89] The Commission uses the SBA's small business size standard applicable to Cellular and Other Wireless Telecommunications, *i.e.*, an entity employing no more than 1,500 persons.[90] There are approximately 1,000 licensees in the Rural Radiotelephone Service, and the Commission estimates that there are 1,000 or fewer small entity licensees in the Rural Radiotelephone Service that may be affected by the rules and policies adopted herein.

37. **Air-Ground Radiotelephone Service**. The Commission has not adopted a small business size standard specific to the Air-Ground Radiotelephone Service.[91] We

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[86] *See 700 MHz Guard Band Auction Closes*, Public Notice, 15 FCC Rcd 18026 (2000).

[87] *See 700 MHz Guard Band Auction Closes*, Public Notice, 16 FCC Rcd 4590 (2001).

[88] *See* 47 C.F.R. § 22.99.

[89] *See* 47 C.F.R. §§ 22.757, 22.759.

[90] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

[91] *See* 47 C.F.R. § 22.99.

will use SBA's small business size standard applicable to Cellular and Other Wireless Telecommunications, *i.e.*, an entity employing no more than 1,500 persons.[92] There are approximately 100 licensees in the Air-Ground Radiotelephone Service, and we estimate that almost all of them qualify as small under the SBA small business size standard and may be affected by rules adopted pursuant to the Further Notice.

38. **Aviation and Marine Radio Services**. Small businesses in the aviation and marine radio services use a very high frequency (VHF) marine or aircraft radio and, as appropriate, an emergency position-indicating radio beacon (and/or radar) or an emergency locator transmitter. The Commission has not developed a small business size standard specifically applicable to these small businesses. For purposes of this analysis, the Commission uses the SBA small business size standard for the category Cellular and Other Telecommunications, which is 1,500 or fewer employees.[93] Most applicants for recreational licenses are individuals. Approximately 581,000 ship station licensees and 131,000 aircraft station licensees operate domestically and are not subject to the radio carriage requirements of any statute or treaty. For purposes of our evaluations in this analysis, we estimate that there are up to approximately 712,000 licensees that are small businesses (or individuals) under the SBA standard. In addition, between December 3, 1998 and December 14, 1998, the Commission held an auction of 42

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[92] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

[93] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

VHF Public Coast licenses in the 157.1875-157.4500 MHz (ship transmit) and 161.775-162.0125 MHz (coast transmit) bands. For purposes of the auction, the Commission defined a "small" business as an entity that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed $15 million dollars.[94] In addition, a "very small" business is one that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed $3 million dollars.[95] There are approximately 10,672 licensees in the Marine Coast Service, and the Commission estimates that almost all of them qualify as "small" businesses under the above special small business size standards and may be affected by rules adopted pursuant to the Further Notice.

39. **Fixed Microwave Services.** Fixed microwave services include common carrier,[96] private operational-fixed,[97] and broadcast auxiliary radio services.[98] At pre-

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[94] *See generally Amendment of the Commission's Rules Concerning Maritime Communications*, PR Docket No. 92-257, Third Report and Order and Memorandum Opinion and Order, 13 FCC Rcd 19853, 19884-88 paras. 64-73 (1998).

[95] *See id.*

[96] *See* 47 C.F.R. §§ 101 *et seq.* (formerly, Part 21 of the Commission's Rules) for common carrier fixed microwave services (except Multipoint Distribution Service).

[97] Persons eligible under parts 80 and 90 of the Commission's Rules can use Private Operational-Fixed Microwave services. *See* 47 C.F.R. Parts 80 and 90. Stations in this service are called operational-fixed to distinguish them from common carrier and public fixed stations. Only the licensee may use the operational-fixed station, and only for communications related to the licensee's commercial, industrial, or safety operations.

[98] Auxiliary Microwave Service is governed by Part 74 of Title 47 of the Commission's Rules. *See* 47 C.F.R. Part 74. This service is available to licensees of broadcast stations and to broadcast and ca-

sent, there are approximately 22,015 common carrier fixed licensees and 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. The Commission has not created a size standard for a small business specifically with respect to fixed microwave services. For purposes of this analysis, the Commission uses the SBA small business size standard for the category Cellular and Other Telecommunications, which is 1,500 or fewer employees.[99] The Commission does not have data specifying the number of these licensees that have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of fixed microwave service licensees that would qualify as small business concerns under the SBA's small business size standard. Consequently, the Commission estimates that there are up to 22,015 common carrier fixed licensees and up to 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services that may be small and may be affected by the rules and policies adopted herein. We note, however, that the common carrier microwave fixed licensee category includes some large entities.

40. **Offshore Radiotelephone Service**. This service operates on several UHF television broadcast channels that are not used for television broadcasting in the

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ble network entities. Broadcast auxiliary microwave stations are used for relaying broadcast television signals from the studio to the transmitter, or between two points such as a main studio and an auxiliary studio. The service also includes mobile television pickups, which relay signals from a remote location back to the studio.

[99] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

coastal areas of states bordering the Gulf of Mexico.[100] There are approximately 55 licensees in this service. We are unable to estimate at this time the number of licensees that would qualify as small under the SBA's small business size standard for Cellular and Other Wireless Telecommunications services.[101] Under that SBA small business size standard, a business is small if it has 1,500 or fewer employees.[102]

41. **Wireless Communications Services.** This service can be used for fixed, mobile, radiolocation, and digital audio broadcasting satellite uses. The Commission established small business size standards for the wireless communications services (WCS) auction. A "small business" is an entity with average gross revenues of $40 million for each of the three preceding years, and a "very small business" is an entity with average gross revenues of $15 million for each of the three preceding years. The SBA has approved these small business size standards.[103] The Commission auctioned geographic area licenses in the WCS service. In the auction, there were seven winning bidders that that qualified as "very small business" entities, and one that qualified as a "small business" entity. We conclude that the number of geographic area WCS licenses affected by this analysis includes these eight entities.

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[100] This service is governed by Subpart I of Part 22 of the Commission's Rules. *See* 47 C.F.R. §§ 22.1001-1037.

[101] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

[102] *See id.*

[103] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

42. **39 GHz Service.** The Commission created a special small business size standard for 39 GHz licenses—an entity that has average gross revenues of $40 million or less in the three previous calendar years.[104] An additional size standard for "very small business" is: an entity that, together with affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years.[105] The SBA has approved these small business size standards.[106] The auction of the 2,173 39 GHz licenses began on April 12, 2000 and closed on May 8, 2000. The 18 bidders who claimed small business status won 849 licenses. Consequently, the Commission estimates that 18 or fewer 39 GHz licensees are small entities that may be affected by rules adopted pursuant to the Further Notice.

43. **Wireless Cable Systems.** Wireless cable systems use 2 GHz band frequencies of the Broadband Radio Service (BRS), formerly Multipoint Distribution Service (MDS),[107] and the Educational Broadband Service (EBS),

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[104] *See Amendment of the Commission's Rules Regarding the 37.0-38.6 GHz and 38.6-40.0 GHz Bands*, ET Docket No. 95-183, PP Docket No. 93-253, Report and Order, 12 FCC Rcd 18600, 18661-64, paras. 149-151 (1997).

[105] *See id.*

[106] *See* Letter to Kathleen O'Brien Ham, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Feb. 4, 1998).

[107] MDS, also known as Multichannel Multipoint Distribution Service (MMDS) has been renamed the Broadband Radio Service (BRS) and is regulated by Part 27 of the Commission's rules; *see* 47 C.F.R. Part 27, subpart M. *See Amendment of Parts 1, 21, 73, 74 and 101 of the Commission's Rules to Facilitate the Provision of Fixed and Mobile Broadband Access, Educational and Other Advanced Services in the 2150-2162 and 2500-2690 MHz Bands*, WT Docket Nos. 03-66, 03-67, 02-68, 00-230, MM Docket No. 97-217, RM-10586, RM-

formerly Instructional Television Fixed Service (ITFS),[108] to transmit video programming and provide broadband services to residential subscribers.[109] These services were originally designed for the delivery of multichannel video programming, similar to that of traditional cable systems, but over the past several years licensees have focused their operations instead on providing two-way high-speed Internet access services.[110] We estimate that the number of wireless cable subscribers is approximately 100,000, as of March 2005. Local Multipoint Distribution Service (LMDS) is a fixed broadband point-to-multipoint microwave service that provides for two-way video telecommunications.[111] As described below, the SBA small business size standard for the broad census category of Cable and Other Program Distribution, which consists of such entities generating $13.5 million or

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9718, Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd 14165 (2004) (*MDS/ITFS Order*).

[108] ITFS, an educational service, has been renamed the Educational Broadband Service (EBS); *see generally*, *MDS/ITFS Order*, 19 FCC Rcd 14165 (2004). EBS systems are regulated by Part 76 of the Commission's rules; *see* 47 C.F.R. Part 76.

[109] *See generally Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 06-189, Notice of Inquiry, 21 FCC Rcd 12229, 12253, para. 71 (2006) (in which the Commission seeks industry comment on new uses of traditional cable systems).

[110] *See id.*

[111] *See Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5-29.5 GHZ Frequency Band, to Reallocate the 29.5-30.0 GHZ Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services*, CC Docket No. 92-297, Second Report and Order, Order on Reconsideration, Fifth Notice of Proposed Rulemaking, 12 FCC Rcd 12545 (1997) (*LMDS Order*).

less in annual receipts, appears applicable to MDS, ITFS and LMDS.[112]

44. The Commission has defined small MDS (now BRS) and LMDS entities in the context of Commission license auctions. In the 1996 MDS auction,[113] the Commission defined a small business as an entity that had annual average gross revenues of less than $40 million in the previous three calendar years. This definition of a small entity in the context of MDS auctions has been approved by the SBA.[114] In the MDS auction, 67 bidders won 493 licenses. Of the 67 auction winners, 61 claimed small business status. At this time, the Commission estimates that of the 61 small business MDS auction winners, 48 remain small business licensees. In addition to the 48 small businesses that hold BTA authorizations, there are approximately 392 incumbent MDS licensees that have gross revenues that are not more than $40 million and are thus considered small entities.[115] MDS licensees and wireless cable operators that did not receive their licenses as a result of the MDS auction fall under the SBA small business size standard for Cable and

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[112] *See* 13 C.F.R. § 121.201, NAICS code 517510.

[113] MDS Auction No. 6 began on Nov. 13, 1995, and closed on Mar. 28, 1996 (67 bidders won 493 licenses).

[114] *See generally Amendment of Parts 21 and 74 of the Commission's Rules with Regard to Filing Procedures in the Multipoint Distribution Service and in the Instructional Television Fixed Service*, MM Docket No. 94-131, Report and Order, 10 FCC Rcd 9589 (1995).

[115] Hundreds of stations were licensed to incumbent MDS licensees prior to implementation of Section 309(j) of the Communications Act of 1934. *See* 47 U.S.C. § 309(j). For these pre-auction licenses, the applicable standard is SBA's small business size standards for "other telecommunications" (annual receipts of $13.5 million or less). *See* 13 C.F.R. § 121.201, NAICS code 517910.

Other Program Distribution.[116] Information available to us indicates that there are approximately 850 of these licensees and operators that do not generate revenue in excess of $13.5 million annually. Therefore, we estimate that there are approximately 850 small entity MDS (or BRS) providers, as defined by the SBA and the Commission's auction rules that may be affected by rules adopted pursuant to the Further Notice.

45. Educational institutions are included in this analysis as small entities; however, the Commission has not created a specific small business size standard for ITFS (now EBS).[117] We estimate that there are currently 2,032 ITFS (or EBS) licensees, and all but 100 of the licenses are held by educational institutions. Thus, we estimate that at least 1,932 ITFS licensees are small entities that may be affected by rules adopted pursuant to the Further Notice.

46. In the 1998 and 1999 LMDS auctions,[118] the Commission defined a small business as an entity that has annual average gross revenues of less than $40 million in the previous three calendar years.[119] Moreover, the Commission added an additional classification for a "very

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[116] *See* 13 C.F.R. § 121.201, NAICS code 517510.

[117] In addition, the term "small entity" under SBREFA applies to small organizations (nonprofits) and to small governmental jurisdictions (cities, counties, towns, townships, villages, school districts, and special districts with populations of less than 50,000). *See* 5 U.S.C. §§ 601(4)-(6). We do not collect annual revenue data on ITFS (now EBS) licensees.

[118] The Commission has held two LMDS auctions: Auction 17 and Auction 23. Auction No. 17, the first LMDS auction, began on Feb. 18, 1998, and closed on Mar. 25, 1998. (104 bidders won 864 licenses.) Auction No. 23, the LMDS re-auction, began on Apr. 27, 1999, and closed on May 12, 1999. (40 bidders won 161 licenses.)

[119] *See generally LMDS Order*, 12 FCC Rcd 12545 (1997).

small business," which was defined as an entity that had annual average gross revenues of less than $15 million in the previous three calendar years.[120] These definitions of "small business" and "very small business" in the context of the LMDS auctions have been approved by the SBA.[121] In the first LMDS auction, 104 bidders won 864 licenses. Of the 104 auction winners, 93 claimed status as small or very small businesses. In the LMDS re-auction, 40 bidders won 161 licenses. Based on this information, we believe that the number of small LMDS licenses will include the 93 winning bidders in the first auction and the 40 winning bidders in the re-auction, for a total of 133 small entity LMDS providers as defined by the SBA and the Commission's auction rules.

47. **218-219 MHz Service.** The first auction of 218-219 MHz spectrum resulted in 170 entities winning licenses for 594 Metropolitan Statistical Area (MSA) licenses. Of the 594 licenses, 557 were won by entities qualifying as a small business. For that auction, the small business size standard was an entity that, together with its affiliates, has no more than a $6 million net worth and, after federal income taxes (excluding any carry over losses), has no more than $2 million in annual profits each year for the previous two years.[122] In the *218-219 MHz Report and Order and Memorandum Opinion and Order*, we established a small business size standard for a "small business" as an entity that, together with its affili-

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[120] *See id.*

[121] *See* Letter to Daniel Phythyon, Chief, Wireless Telecommunications Bureau (FCC) from A. Alvarez, Administrator, SBA (Jan. 6, 1998).

[122] *See generally Implementation of Section 309(j) of the Communications Act—Competitive Bidding*, PP Docket No. 93-253, Fourth Report and Order, 9 FCC Rcd 2330 (1994).

ates and persons or entities that hold interests in such an entity and their affiliates, has average annual gross revenues not to exceed $15 million for the preceding three years.[123] A "very small business" is defined as an entity that, together with its affiliates and persons or entities that hold interests in such an entity and its affiliates, has average annual gross revenues not to exceed $3 million for the preceding three years.[124] These size standards will be used in future auctions of 218-219 MHz spectrum.

48. **24 GHz—Incumbent Licensees.** This analysis may affect incumbent licensees who were relocated to the 24 GHz band from the 18 GHz band, and applicants who wish to provide services in the 24 GHz band. The applicable SBA small business size standard is that of "Cellular and Other Wireless Telecommunications" companies. This category provides that such a company is small if it employs no more than 1,500 persons.[125] We believe that there are only two licensees in the 24 GHz band that were relocated from the 18 GHz band, Teligent[126] and TRW, Inc. It is our understanding that Teligent and its related companies have less than 1,500 employees, though this may change in the future. TRW is not a small entity. Thus, only one incumbent licensee in the 24 GHz band is a small business entity.

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[123] *See generally Amendment of Part 95 of the Commission's Rules to Provide Regulatory Flexibility in the 218-219 MHz Service*, WT Docket No. 98-169, Report and Order and Memorandum Opinion and Order, 15 FCC Rcd 1497 (1999).

[124] *See id.*

[125] *See* 13 C.F.R. § 121.201, NAICS code 517212 (This category will be changed for purposes of the 2007 Census to "Wireless Telecommunications Carriers (except Satellite)," NAICS code 517210.).

[126] Teligent acquired the DEMS licenses of FirstMark, the only licensee other than TRW in the 24 GHz band whose license has been modified to require relocation to the 24 GHz band.

49. **24 GHz—Future Licensees.** With respect to new applicants in the 24 GHz band, the size standard for "small business" is an entity that, together with controlling interests and affiliates, has average annual gross revenues for the three preceding years not in excess of $15 million.[127] "Very small business" in the 24 GHz band is an entity that, together with controlling interests and affiliates, has average gross revenues not exceeding $3 million for the preceding three years.[128] The SBA has approved these small business size standards.[129] These size standards will apply to a future 24 GHz license auction, if held.

2. Satellite Service Providers

50. **Satellite Telecommunications.** Since 2007, the SBA has recognized satellite firms within this revised category, with a small business size standard of $15 million.[130] The most current Census Bureau data, however, are from the (last) economic census of 2002, and we will use those figures to gauge the prevalence of small businesses in this category. Those size standards are for the two census categories of "Satellite Telecommunications" and "Other Telecommunications." Under both prior

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[127] *See Amendments to Parts 1, 2, 87 and 101 of the Commission's Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd 16934, 16967 at para. 77 (2000); *see also* 47 C.F.R. § 101.538(a)(2).

[128] *See Amendments to Parts 1, 2, 87 and 101 of the Commission's Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd 16934, 16967 at para. 77 (2000); *see also* 47 C.F.R. § 101.538(a)(1).

[129] *See* Letter to Margaret W. Wiener, Deputy Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Gary M. Jackson, Assistant Administrator, SBA (July 28, 2000).

[130] *See* 13 C.F.R. § 121.201, NAICS code 517410.

categories, such a business was considered small if it had, as now, $15 million or less in average annual receipts.[131]

51. The first category of Satellite Telecommunications "comprises establishments primarily engaged in providing point-to-point telecommunications services to other establishments in the telecommunications and broadcasting industries by forwarding and receiving communications signals via a system of satellites or reselling satellite telecommunications."[132] For this category, Census Bureau data for 2002 show that there were a total of 371 firms that operated for the entire year.[133] Of this total, 307 firms had annual receipts of under $10 million, and 26 firms had receipts of $10 million to $24,999,999.[134] Consequently, we estimate that the majority of Satellite Telecommunications firms are small entities that might be affected by rules adopted pursuant to the Further Notice.

52. The second category of Other Telecommunications "comprises establishments primarily engaged in (1) providing specialized telecommunications applications, such as satellite tracking, communications telemetry, and radar station operations; or (2) providing satellite terminal stations and associated facilities operationally connected with one or more terrestrial communications systems and capable of transmitting telecommunications to or receiving telecommunications from satellite sys-

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[131] *See* 13 C.F.R. § 121.201, NAICS codes 517410 and 517910.

[132] U.S. Census Bureau, 2002 NAICS Definitions, "517410 Satellite Telecommunications"; http://www.census.gov/epcd/naics02/def/NDEF517.HTM.

[133] *See* 13 C.F.R. § 121.201, NAICS code 517410.

[134] *See id.* An additional 38 firms had annual receipts of $25 million or more.

tems."[135] For this category, Census Bureau data for 2002 show that there were a total of 332 firms that operated for the entire year.[136] Of this total, 303 firms had annual receipts of under $10 million and 15 firms had annual receipts of $10 million to $24,999,999.[137] Consequently, we estimate that the majority of Other Telecommunications firms are small entities that might be affected by our action.

3. Cable and OVS Operators

53. In 2007, the SBA recognized new census categories for small cable entities.[138] However, there is no census data yet in existence that may be used to calculate the number of small entities that fit these definitions. Therefore, we will use prior definitions of these types of entities in order to estimate numbers of potentially-affected small business entities.

54. **Cable and Other Program Distribution**. The Census Bureau defines this category as "third-party distribution systems for broadcast programming. . . . [that] deliver visual, aural, or textual programming received from cable networks, local television stations, or radio networks to consumers via cable or direct-to-home satellite systems on a subscription or fee basis . . . [and] do not generally originate programming material."[139] The SBA

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[135] U.S. Census Bureau, 2002 NAICS Definitions, "517910 Other Telecommunications"; http://www.census.gov/epcd/naics02/def/NDEF517.HTM.

[136] *See* 13 C.F.R. § 121.201, NAICS code 517910.

[137] *See id.* An additional 14 firms had annual receipts of $25 million or more.

[138] *See* 13 C.F.R. § 121.201.

[139] U.S. Census Bureau, 2002 NAICS Definitions, "517510 Cable and Other Program Distribution"; http://www.census.gov/epcd/naics02/def/NDEF517.HTM.

has developed a small business size standard for Cable and Other Program Distribution, of firms having $13.5 million or less in annual receipts.[140] According to Census Bureau data for 2002, there were a total of 1,191 firms in this category that operated for the entire year.[141] Of this total, 1,087 firms had annual receipts of under $10 million, and 43 firms had receipts of $10 million or more but less than $25 million.[142] Thus, under this size standard, the majority of firms can be considered small and may be affected by rules adopted pursuant to the Further Notice.

55. **Cable Companies and Systems**. The Commission has developed its own small business size standards, for the purpose of cable rate regulation. Under the Commission's rules, a "small cable company" is one serving 400,000 or fewer subscribers, nationwide.[143] Industry data indicate that, of 1,076 cable operators nationwide, all but eleven are small under this size standard.[144] In addi-

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[140] *See* 13 C.F.R. § 121.201, NAICS code 517510 (This category will be changed for purposes of the 2007 Census to "Wired Telecommunications Carriers," NAICS code 517110.).

[141] *See id.*

[142] *Id.* An additional 61 firms had annual receipts of $25 million or more.

[143] *See* 47 C.F.R. § 76.901(e). The Commission determined that this size standard equates approximately to a size standard of $100 million or less in annual revenues. *See Implementation of Sections of the 1992 Cable Television Consumer Protection and Competition Act: Rate Regulation*, Sixth Report and Order and Eleventh Order on Reconsideration, 10 FCC Rcd 7393, 7408 at para. 28 (1995).

[144] These data are derived from R.R. BOWKER, BROADCASTING & CABLE YEARBOOK 2006, "Top 25 Cable/Satellite Operators," pages A-8 & C-2 (data current as of June 30, 2005); WARREN COMMUNICATIONS NEWS, TELEVISION & CABLE FACTBOOK 2006, "Ownership of Cable Systems in the United States," pages D-1805 to D-1857.

tion, under the Commission's rules, a "small system" is a cable system serving 15,000 or fewer subscribers.[145] Industry data indicate that, of 7,208 systems nationwide, 6,139 systems have under 10,000 subscribers, and an additional 379 systems have 10,000-19,999 subscribers.[146] Thus, under this second size standard, most cable systems are small and may be affected by rules adopted pursuant to the Further Notice.

56. **Cable System Operators.** The Act also contains a size standard for small cable system operators, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[147] The Commission has determined that an operator serving fewer than 677,000 subscribers shall be deemed a small operator, if its annual revenues, when combined with the total annual revenues of all its affiliates, do not exceed $250 million in the aggregate.[148] Industry data indicate that, of 1,076 cable operators nationwide, all but ten are small under this size standard.[149] We note that the Commission neither

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[145] *See* 47 C.F.R. § 76.901(c).

[146] WARREN COMMUNICATIONS NEWS, TELEVISION & CABLE FACTBOOK 2006, "U.S. Cable Systems by Subscriber Size," page F-2 (data current as of Oct. 2005). The data do not include 718 systems for which classifying data were not available.

[147] 47 U.S.C. § 543(m)(2); *see also* 47 C.F.R. § 76.901(f) & nn.1-3.

[148] 47 C.F.R. § 76.901(f); *see FCC Announces New Subscriber Count for the Definition of Small Cable Operator*, Public Notice, 16 FCC Rcd 2225 (Cable Services Bureau 2001).

[149] These data are derived from R.R. BOWKER, BROADCASTING & CABLE YEARBOOK 2006, "Top 25 Cable/Satellite Operators," pages A-8 & C-2 (data current as of June 30, 2005); WARREN COMMUNICA-

requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250 million,[150] and therefore we are unable to estimate more accurately the number of cable system operators that would qualify as small under this size standard.

57. **Open Video Services.** Open Video Service (OVS) systems provide subscription services.[151] As noted above, the SBA has created a small business size standard for Cable and Other Program Distribution.[152] This standard provides that a small entity is one with $13.5 million or less in annual receipts. The Commission has certified approximately 45 OVS operators to serve 75 areas, and some of these are currently providing service.[153] Affiliates of Residential Communications Network, Inc. (RCN) received approval to operate OVS systems in New York City, Boston, Washington, D.C., and other areas. RCN has sufficient revenues to assure that they do not qualify as a small business entity. Little financial information is available for the other entities that are authorized to provide OVS and are not yet operational. Given that some entities authorized to provide OVS service have not yet begun to generate revenues, the Commis-

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TIONS NEWS, TELEVISION & CABLE FACTBOOK 2006, "Ownership of Cable Systems in the United States," pages D-1805 to D-1857.

[150] The Commission does receive such information on a case-by-case basis if a cable operator appeals a local franchise authority's finding that the operator does not qualify as a small cable operator pursuant to § 76.901(f) of the Commission's rules.

[151] *See* 47 U.S.C. § 573.

[152] *See* 13 C.F.R. § 121.201, NAICS code 517510 (This category will be changed for purposes of the 2007 Census to "Wired Telecommunications Carriers," NAICS code 517110.).

[153] *See* http://www.fcc.gov/mb/ovs/csovscer.html (current as of Feb. 2007).

sion concludes that up to 44 OVS operators (those remaining) might qualify as small businesses that may be affected by rules adopted pursuant to the Further Notice.

4. Internet Service Providers, Web Portals and Other Information Services

58. In 2007, the SBA recognized two new small business, economic census categories: (1) Internet Publishing and Broadcasting and Web Search Portals[154] and; (2) All Other Information Services.[155] However, there is no census data yet in existence that may be used to calculate the number of small entities that fit these definitions. Therefore, we will use prior definitions of these types of entities in order to estimate numbers of potentially-affected small business entities.

59. **Internet Service Providers**. The SBA has developed a small business size standard for Internet Service Providers (ISPs). ISPs "provide clients access to the Internet and generally provide related services such as web hosting, web page designing, and hardware or software consulting related to Internet connectivity."[156] Under the SBA size standard, such a business is small if it has average annual receipts of $23 million or less.[157] According to Census Bureau data for 2002, there were 2,529 firms in this category that operated for the entire year.[158]

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[154] *See* 13 C.F.R. § 121.201, NAICS code 519130 (establishing a $500,000 revenue ceiling).

[155] *See* 13 C.F.R. § 121.201, NAICS code 519190 (establishing a $6.5 million revenue ceiling).

[156] U.S. Census Bureau, "2002 NAICS Definitions: 518111 Internet Service Providers"; http://www.census.gov/epcd/naics02/def/NDEF518.HTM.

[157] *See* 13 C.F.R. § 121.201, NAICS code 518111.

[158] *See* 13 C.F.R. § 121.201, NAICS code 518111.

Of these, 2,437 firms had annual receipts of under $10 million, and an additional 47 firms had receipts of between $10 million and $24,999,999. Consequently, we estimate that the majority of these firms are small entities that may be affected by rules adopted pursuant to the Further Notice.

60. **Web Search Portals.** Our action may pertain to interconnected VoIP services, which could be provided by entities that provide other services such as email, online gaming, web browsing, video conferencing, instant messaging, and other, similar IP-enabled services. The Commission has not adopted a size standard for entities that create or provide these types of services or applications. However, the Census Bureau has identified firms that "operate web sites that use a search engine to generate and maintain extensive databases of Internet addresses and content in an easily searchable format."[159] The SBA has developed a small business size standard for this category of $6.5 million or less in average annual receipts.[160] According to Census Bureau data for 2002, there were 342 firms in this category that operated for the entire year.[161] Of these, 303 had annual receipts of under $5 million, and an additional 15 firms had receipts of between $5 million and $9,999,999. Consequently, we estimate that the majority of these firms are small entities that may be affected by rules adopted pursuant to the Further Notice.

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[159] U.S. Census Bureau, "2002 NAICS Definitions: 518112 Web Search Portals"; http://www.census.gov/epcd/naics02/def/NDEF518.HTM.

[160] *See* 13 C.F.R. § 121.201, NAICS code 518112.

[161] *See* 13 C.F.R. § 121.201, NAICS code 518112.

61. **Data Processing, Hosting, and Related Services.** Entities in this category "primarily . . . provid[e] infrastructure for hosting or data processing services."[162] The SBA has developed a small business size standard for this category; that size standard is $23 million or less in average annual receipts.[163] According to Census Bureau data for 2002, there were 6,877 firms in this category that operated for the entire year.[164] Of these, 6,418 had annual receipts of under $10 million, and an additional 251 firms had receipts of between $10 million and $24,999,999. Consequently, we estimate that the majority of these firms are small entities that may be affected by rules adopted pursuant to the Further Notice.

62. **All Other Information Services.** The Census Bureau defines this industry as including "establishments primarily engaged in providing other information services (except new syndicates and libraries and archives)."[165] Our action pertains to interconnected VoIP services, which could be provided by entities that provide other services such as email, online gaming, web browsing, video conferencing, instant messaging, and other, similar IP-enabled services. The SBA has developed a small business size standard for this category; that size standard is $6.5 million or less in average annual receipts.[166] According to Census Bureau data for 2002,

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[162] U.S. Census Bureau, "2002 NAICS Definitions: 518210 Data Processing, Hosting, and Related Services"; http://www.census.gov/epcd/naics02/def/NDEF518.HTM.

[163] *See* 13 C.F.R. § 121.201, NAICS code 518210.

[164] *See* 13 C.F.R. § 121.201, NAICS code 518210.

[165] U.S. Census Bureau, "2002 NAICS Definitions: 519190 All Other Information Services"; http://www.census.gov/epcd/naics02/def/NDEF519.HTM.

[166] *See* 13 C.F.R. § 121.201, NAICS code 519190.

there were 155 firms in this category that operated for the entire year.[167] Of these, 138 had annual receipts of under $5 million, and an additional four firms had receipts of between $5 million and $9,999,999. Consequently, we estimate that the majority of these firms are small entities that may be affected by our action.

63. **Internet Publishing and Broadcasting**. The Census Bureau defines this industry as "establishments engaged in publishing and/or broadcasting content on the Internet exclusively. . . . [that . . .] do not provide traditional (non-Internet) versions of the content that they publish or broadcast."[168] The SBA has developed a small business size standard for this Census category; that size standard is 500 or fewer employees.[169] According to Census Bureau data for 2002, there were 1,362 firms in this category that operated for the entire year.[170] Of these, 1,351 had employment of 499 or fewer employees, and 11 firms had employment of between 500 and 999. Consequently, we estimate that the majority of these firms are small entities that may be affected by our action.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements for Small Entities

64. In the Further Notice, the Commission seeks comment on issues that must be addressed to comprehensively reform intercarrier compensation. These issues include the Commission's jurisdiction to adopt such

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[167] *See* 13 C.F.R. § 121.201, NAICS code 519190.

[168] U.S. Census Bureau, "2002 NAICS Definitions: 516110 Internet Publishing and Broadcasting"; http://www.census.gov/epcd/naics02/def/NDEF516.HTM.

[169] *See* 13 C.F.R. § 121.201, NAICS code 516110.

[170] *See* 13 C.F.R. § 121.201, NAICS code 516110.

reform, how relevant statutory provisions should be interpreted and applied, and if and how carriers should be allowed to recover revenues that might be reduced by any intercarrier compensation reforms. In addition, the Commission seeks comment on the transition to the elimination of originating access. Compliance with a transition away from originating access charges will apply to all carriers but may prove financially burdensome to some small entities and may include new or reduced administrative processes.

65. The Commission currently does not regulate the provision of transit service between carriers and many carriers have entered into agreements governing the provision of transit traffic. Rules imposing transit service obligations will likely have no significant impact on carriers already providing, or carriers already using, transit service. For carriers that would be affected, the burdens may include determining the price of transit service purchased and/or provided, and developing additional administrative capabilities to account for providing and/or receiving transit service.

66. In this Further Notice the Commission also seeks comment on whether carriers will be able to receive universal service support to recover net reduced revenues from intercarrier compensation as a result of reforms that could be adopted. To allow rate-of-return carriers to receive universal service support in this manner, we may need to modify existing rules. For carriers that may be affected, burdens may include certain reporting and recordkeeping requirements to determine and establish their eligibility to receive such universal service support. Additionally, these carriers may need to modify some administrative processes in order to comply with any new

or revised rules the Commission adopts as a result of the Further Notice.

67. Possible modifications to the rules in Part 51, if adopted, will affect all carriers. Possible modifications to the rules in Part 61 of the Commission's rules, if adopted, will affect all carriers that file and/or modify tariff filings. For example, modified rules may decrease or increase a carriers' tariff filing requirements. Modifications to the rules in Part 69 of the Commission's rules, if adopted, will affect all carriers that receive and/or pay access charges. Such revisions could require modifications to carrier billing systems and associated reporting and recordkeeping systems. Additionally, modification of the Commission's Part 69 rules may require carriers to modify and/or establish intercarrier compensation agreements.

68. As part of the Further Notice, the Commission seeks comment on reforming the high-cost disbursement mechanism, including the use of reverse auctions, and how best to implement changes to the universal service contribution mechanism. Compliance with a new universal service contribution mechanism will apply to all carriers, which may prove financially burdensome to small entities as they make changes from reporting information based on the revenue-based mechanism. Changes to the high-cost mechanism, and adoption of a broadband pilot program for low-income consumers may also necessitate additional reporting and recordkeeping requirements. Additionally, these proposed changes necessary to implement comprehensive reform also may require changes to Part 54 of the Commission's rules and will affect carriers subject to those rules.

E. Steps Taken to Minimize the Significant Economic Impact on Small Entities, and Significant Alternatives Considered

The RFA requires an agency to describe any significant, specifically small business, alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): "(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for such small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for such small entities."[171]

70. The Further Notice seeks comment from all interested parties. Small entities are encouraged to bring to the Commission's attention any specific concerns they may have with the proposals outlined in the Further Notice.

71. Throughout these proceedings the Commission has received proposals to treat small entities differently. We believe that consideration of commenters' transition proposals for implementing intercarrier compensation reform, as well as alternatives for a carriers' recovery of intercarrier revenues reduced as a result of any reforms that might be adopted could be consistent with our goals of a unified and simplified intercarrier compensation regime that will reduce arbitrage opportunities and promote innovation and competition and our statutory requirement to secure the viability of universal service.

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[171] 5 U.S.C. § 603(c)(1)-(c)(4).

F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules

72. None.

FEDERAL COMMUNICATIONS COMMISSION
FCC 08-262

STATEMENT OF
CHAIRMAN KEVIN J. MARTIN

Re: *High-Cost Universal Service Support*, WC Docket No. 05-337; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Lifeline and Link Up*, WC Docket No. 03-109; *Universal Service Contribution Methodology*, WC Docket No. 06-122; *Numbering Resource Optimization*, CC Docket No. 99-200; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68; *IP-Enabled Services*, WC Docket No. 04-36

Today we tell the U.S. Court of Appeals for the D.C. Circuit and the Federal-State Joint Board on Universal Service that, after years of deliberation, we are still unready to move forward with comprehensive reform of intercarrier compensation and universal service. Instead, we issue another open-ended Further Notice of Proposed Rulemaking on a variety of approaches for comprehensive reform, and my colleagues promise to act on it by December 18.

I am disappointed by the Commission's unwillingness to step up and make tough choices to modernize our intercarrier compensation and universal service programs. I am also doubtful that the Commission will find itself any better equipped to act in another six weeks. However, I vote to approve this item because this is the only path my colleagues could agree on, and failure to respond

to the Court in particular would result in an even sorrier state of affairs—immediate vacatur of our rules.

First, I am skeptical of today's response to the Court, which directed us to justify the Commission's interim intercarrier compensation rules for ISP-bound traffic. The Order treats ISP-bound traffic differently than all other traffic, including other IP traffic. The Order retains the interim rate cap of $0.0007 for terminating this traffic indefinitely. I doubt that an Order that retains artificial and unsupported distinctions between types of IP traffic and maintains an interim rate without establishing an end game will be seen any more favorably by the Court than the Commission's two previous attempts.

By singling out ISP-bound traffic for different treatment, we perpetuate the current patchwork of rates for different traffic. The Order argues that disparate treatment of ISP-bound traffic is justified to combat arbitrage. Yet arbitrage exists precisely because traffic is terminated at a variety of rates.

In addition, the $0.0007 rate cap for ISP-bound traffic was intended to be an interim measure pending comprehensive reform of intercarrier compensation. Indeed, the record does not support a differential rate for ISP-bound traffic except on an interim basis. And even then, $0.0007 can only be justified as an interim rate under a cost standard that we fail to adopt. A rate of $0.0007 is inconsistent with the current TELRIC standard, and the Order does not adequately explain why we retain this rate in the absence of moving forward with adopting a cost standard consistent with $0.0007. However, the Order simply states that the $0.0007 cap shall remain in place until we adopt more comprehensive intercarrier compensation reform. That is, we are establishing a perpetual interim rate. Although the Order is silent as to whether the

$0.0007 rate is "interim," let's be clear—this is an interim rate to nowhere. I therefore believe that we have failed to respond to the Court.

In 2005, the Court denied an earlier mandamus petition based on the Commission's representation that it was committed to comprehensive reform. The Commission pointed to its Further Notice on comprehensive reform, including permanent rules to succeed the interim intercarrier compensation regime for ISP-bound traffic.

Three years later, the Commission once again finds itself asking the Court not to vacate our rules because the Commission remains committed to comprehensive reform. And once again, the Commission points to a Further Notice on comprehensive reform as evidence of its commitment.

I question whether my colleagues will be any more willing to adopt comprehensive reform in December. As explained below, I believe when December comes, the other Commissioners will simply pursue another Further Notice and another round of comment on the most difficult issues. If the Court wants a response—and is willing to give the Commission the benefit of the doubt rather than vacate our rules immediately—it should enforce our promise of reform on pain of automatic vacatur on December 19.

It is unfortunate that the Commission could not agree to adopt the comprehensive solution. I had proposed a comprehensive approach that would have transitioned all traffic to a final uniform rate, regardless of the type of traffic or jurisdiction. This approach would have answered the Court's direction—and I think it would have done so in a legally sustainable way.

Specifically, I would have concluded that all traffic falls within section 251(b)(5) and called upon each state to set a glide path to a reciprocal compensation rate applicable to all traffic under section 252(d)(2). Under this proposal, traffic terminated at rates below the glide path, such as ISP-bound traffic, would continue to be terminated at those rates, on an interim basis, until such traffic is swept into the glide path. Ultimately, the glide path would end at a lower, final uniform rate for all traffic.

Second, I view our failure to implement the Joint Board's recommendations as a tremendous missed opportunity. In particular, I supported the Joint Board's determination that broadband should be included in the universal service program. As I have said before, to fully appreciate and take advantage of the Internet today, consumers need broadband connections. Without this underlying infrastructure, efforts to implement advances in how we communicate, work, and provide education cannot succeed.

My proposal for implementing this recommendation would have spurred rapid and widespread deployment of broadband. I would have asked each carrier receiving high-cost universal service support to commit to provide broadband to all consumers in its study area within 5 years as a condition of continuing to receive support. If a carrier did not make that commitment, we would conduct a reverse auction to find out if any other carrier could do so. If nobody came forward, then we would have identified an unserved area, and could then determine what additional steps might be necessary to bring broadband to those consumers. In addition, I would have created a broadband Lifeline and Link Up program to ensure that low income consumers are not left out of our broadband future.

Finally, I am disappointed with the Further Notice issued today. After a decade of comment on these issues, we begin again from square one. To be clear, this is not a targeted Further Notice on a specific reform proposal. We are putting out for comment several proposals that would lead to radically different outcomes. In the Further Notice and in my colleagues' statement, my colleagues invite comment on conflicting questions, which reveal that they have no fundamental proposal for reform.

- Do we include broadband within the universal service program—or not?
- Do we provide support to competitive carriers based on their own costs? A reverse auction? Or do we phase out their support altogether?
- Should terminating rates be uniform by state—or uniform by carrier?
- Should we use an incremental cost standard for setting termination rates—or the existing TELRIC standard?

These questions have been debated exhaustively in the record for years. I fail to see how further comment over the next six weeks will help us resolve these issues.

Indeed, the longer we wait, the more difficult these issues become. Regulatory arbitrage will increase as long as rates differ by type of traffic and jurisdiction. Moreover, carriers are booking IP traffic at vastly different rates that must be reconciled eventually. This type of traffic will continue to grow as carriers invest in broadband networks.

I would like to be encouraged by my colleagues' commitment that they will truly be ready to complete this much needed reform on December 18. The nature of the

questions they included in the Further Notice makes me doubt they will have found their answers within an additional six weeks. I believe the far more likely outcome is that, in December, the other Commissioners will merely want another Further Notice and another round of comment on the most difficult questions. I do not believe they will be prepared to address the most challenging issues and that the Commission will be negotiating over what further questions to ask in December.

I recognize that few other issues before the Commission are as technically complex and involved, with as many competing interests, as are reforming the intercarrier compensation and universal service programs. But neither of those two realities are excuse for inaction.

FEDERAL COMMUNICATIONS COMMISSION
FCC 08-262

JOINT STATEMENT OF COMMISSIONERS MICHAEL J. COPPS, JONATHAN S. ADELSTEIN, DEBORAH TAYLOR TATE AND ROBERT M. MCDOWELL

Re: *High-Cost Universal Service Support*, WC Docket No. 05-337; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Lifeline and Link Up*, WC Docket No. 03-109; *Universal Service Contribution Methodology*, WC Docket No. 06-122; *Numbering Resource Optimization*, CC Docket No. 99-200; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68; IP-*Enabled Services*, WC Docket No. 04-36

Today's decision responds directly to the mandamus from the D.C. Circuit Court of Appeals regarding Core Communications, Inc. The item sets forth the Commission's legal justification for the rules it adopted in 2001 governing intercarrier compensation for telecommunications traffic bound for Internet service providers. It also preserves the ability to move towards a more unified intercarrier compensation regime.

We also issue a Further Notice seeking comment on specific proposals to reform the intercarrier compensation and universal service systems. While we do not prejudge any of the proposals set forth therein, we do believe that there is a tentative but growing measure of consensus on a number of issues, including: moving in-

trastate access rates to interstate access levels over a reasonable period of time; not unduly burdening consumers with increases in their rates untethered to reductions in access charges; addressing phantom traffic and traffic stimulation; implementing an alternative cost recovery mechanism in certain circumstances; eliminating the identical support rule and moving over time towards support based on a company's own costs; emphasizing the importance of broadband to the future of universal service; and clarifying the implementation of the Alaska Native regions and tribal lands exception to the CETC cap adopted on May 1, 2008, and the need for special consideration for such areas. We would appreciate stakeholders['] attention to these issues of concern and consideration of whether modifications along these lines to the attached proposals are warranted. This Further Notice reflects our commitment to comprehensive reform of the intercarrier compensation and universal service systems in an expedited fashion.

Finally, the Commission today has completed a proceeding to consider the recommendations of the Federal-State Joint Board on Universal Service. We appreciate all of the valuable input that the Board has provided the Commission. We however choose not to implement the Joint Board's recommendations at this time. We thank the Board members for their tireless efforts and look forward to obtaining their valuable input on an ongoing basis.

For the foregoing reasons, we are pleased to approve today's Report & Order and Further Notice of Proposed Rulemaking.

Supreme Court, U.S.
FILED

No. 10-185 AUG 6- 2010

IN THE OFFICE OF THE CLERK

Supreme Court of the United States

CORE COMMUNICATIONS, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI (VOLUME III OF III)

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TABLE OF CONTENTS

Page

Volume I

Appendix A – Court of Appeals Opinion in *Core Communications, Inc.* v. *FCC*, 592 F.3d 139 (D.C. Cir. 2010) 1a

Appendix B – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 15a

Volume II

Appendix B (continued) – Federal Communications Commission Order in *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic*, 24 F.C.C.R. 6475 (Nov. 5, 2008) 399a

Volume III

Appendix C – Court of Appeals Opinion in *In re Core Communications, Inc.*, 531 F.3d 849 (D.C. Cir. 2008) 792a

Appendix D – Court of Appeals Opinion in *In re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006) 819a

TABLE OF CONTENTS—Continued

Page

Appendix E – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. May 24, 2005) 847a

Appendix F – Court of Appeals Order in *In re Core Communications, Inc.*, No. 04-1179 (D.C. Cir. Nov. 22, 2004) 848a

Appendix G – Federal Communications Commission Order in *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the* ISP Remand Order, 19 F.C.C.R. 20,179 (Oct. 18, 2004) 849a

Appendix H – Court of Appeals Opinion in *WorldCom, Inc.* v. *FCC*, 288 F.3d 429 (D.C. Cir. 2002) 872a

Appendix I – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 F.C.C.R. 9151 (Apr. 27, 2001) 882a

Appendix J – Court of Appeals Opinion in *Bell Atlantic Telephone Cos.* v. *FCC*, 206 F.3d 1 (D.C. Cir. 2000) 1015a

TABLE OF CONTENTS—Continued

Page

Appendix K – Federal Communications Commission Order in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 F.C.C.R. 3689 (Feb. 26, 1999)..... 1032a

Appendix L – Court of Appeals Order Denying Panel Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010)..... 1085a

Appendix M – Court of Appeals Order Denying *En Banc* Rehearing in *Core Communications, Inc.* v. *FCC*, No. 08-1365 (Mar. 26, 2010)..... 1087a

Appendix N – Relevant Statutory Provisions 1089a

APPENDIX C
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 07-1446

IN RE CORE COMMUNICATIONS, INC.,
Petitioner,

ARGUED MAY 5, 2008
DECIDED JULY 8, 2008

On Petition for Writ of Mandamus to the
Federal Communications Commission

Before: TATEL, GARLAND, and GRIFFITH, Circuit Judges.

Opinion for the Court filed by Circuit Judge GARLAND.

Concurring opinion filed by Circuit Judge GRIFFITH.

GARLAND, Circuit Judge:

The Federal Communications Commission (FCC) has twice failed to articulate a valid legal justification for its rules governing intercarrier compensation for telecommunications traffic bound for Internet service providers (ISPs). In March 2000, this court vacated and remanded the Commission's first attempt at a justification. In May 2002, we rejected its second attempt, in that case remanding without vacating because we thought there was

a "non-trivial likelihood" the Commission would be able to state a valid legal basis for its rule.

No such justification has been forthcoming. Core Communications, Inc., which is injured by the FCC's rules, has filed a petition for a writ of mandamus, seeking an order compelling the Commission to explain the legal authority upon which the rules are based, on pain of vacatur if it fails to do so within a fixed time. This is Core's second petition seeking such relief. We dismissed its first in 2005, "without prejudice to refiling in the event of significant additional delay." That delay has now come to pass. It has been three years since we dismissed Core's first petition and six years since we remanded the case to the FCC to do nothing more than state the legal justification for its rules. At this point, the FCC's delay in responding to our remand is egregious.

We therefore grant the writ of mandamus sought by Core and direct the FCC to explain the legal basis for its ISP-bound compensation rules within six months of the date of the oral argument in this case. There will be no extensions of that deadline. The rules will be vacated on the day after the deadline, unless the court is notified that the Commission has complied with our direction.

I

Our opinion in *In re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006), sets forth much of the background necessary to understand how this case arrived at its current juncture, and we therefore borrow liberally from that exposition. As we explained in *Core*, before high-speed broadband connections (such as cable modem and digital subscriber line (DSL) service) became widely available, consumers generally gained access to the Internet through "dial-up" connections provided by local telephone companies. Under the dial-up method, a con-

sumer uses a line provided by a local exchange carrier (LEC)—usually an incumbent local exchange carrier (ILEC)—to dial the local telephone number of an Internet service provider (ISP), which then connects the call to the Internet. Typically, the ISP does not subscribe to the ILEC, but instead subscribes to another LEC—a competitive local exchange carrier (CLEC)—that interconnects with the incumbent. Accordingly, a consumer who dials up to the Internet usually obligates an originating ILEC to transfer the call to a CLEC, which then delivers the call to the ISP. Core is a CLEC. *See id.* at 270.

How this call is paid for is at the center of Core's dispute with the FCC. Section 251(b)(5) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996, requires LECs to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). Under a reciprocal compensation arrangement, "[w]hen a customer of carrier A makes a local call to a customer of carrier B, and carrier B uses its facilities to connect, or 'terminate,' that call to its own customer, the 'originating' carrier A is ordinarily required to compensate the 'terminating' carrier B for the use of carrier B's facilities." *SBC Inc. v. FCC*, 414 F.3d 486, 490 (3d Cir. 2005) (citing *Global NAPs, Inc. v. FCC*, 247 F.3d 252, 254 (D.C. Cir. 2001)); *see In re Core*, 455 F.3d at 270.

If ISP-bound traffic were governed by § 251(b)(5), reciprocal compensation arrangements would be required for the ILEC-to-CLEC hand-off just described, and ILECs would be required to compensate CLECs like Core—for completing their customers' calls to ISPs. In 1996, however, the FCC construed the "reciprocal compensation arrangements" provision of § 251(b)(5) to

"apply only to traffic that originates and terminates within a local area." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15,499, 16,013, ¶ 1034, 1996 WL 452885 (1996). And in its 1999 *Declaratory Ruling*, the Commission concluded that dial-up calls to an ISP for connection to the Internet are non-local, and thus that § 251(b)(5) is inapplicable. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689, 1999 WL 98037 (1999) ("*Declaratory Ruling*"). Instead, the FCC concluded that ISP-bound calls constitute interstate traffic, subject to FCC jurisdiction under § 201 of the Act.[1] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9152, ¶ 1, 2001 WL 455869 (2001) ("*ISP Remand Order*") (construing the *Declaratory Ruling*).

In March 2000, this court held that the Commission had inadequately explained its determination that ISP-bound traffic is non-local. *See Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1, 7-8 (D.C. Cir. 2000). The FCC, we said, had failed to "provide an explanation why th[e] [end-to-end]

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[1] Section 201 provides, in relevant part:

(a) It shall be the duty of every common carrier engaged in interstate . . . communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission . . . finds such action necessary or desirable in the public interest, to establish . . . charges applicable thereto and the divisions of such charges. . . .

(b) All charges . . . for and in connection with such communication service, shall be just and reasonable. . . .

47 U.S.C. § 201.

inquiry is relevant to discerning whether a call to an ISP should fit within the local call model . . . or the long-distance model." *Id.* at 5. We vacated and remanded the *Declaratory Ruling*, directing the FCC to justify its determination. *Id.* at 9.

In 2001, the FCC responded to our decision in *Bell Atlantic* with the *ISP Remand Order*. Once again, the Commission concluded that calls delivered to ISPs are not subject to the reciprocal compensation obligations of § 251(b)(5). *See ISP Remand Order*, 16 FCC Rcd at 9154, ¶ 3. But this time, rather than base its conclusion on a determination that ISP-bound calls are non-local and hence not subject to § 251(b)(5), the Commission relied on a different statutory section, 47 U.S.C. § 251(g).[2] *See id.* at 9153, ¶ 1. According to the FCC, § 251(g) was intended to exclude the kinds of traffic enumerated in that subsection, specifically "exchange access, information access, and exchange services for such access," from the reciprocal compensation requirement of § 251(b)(5). *Id.* at 9166-67, ¶ 34 (quoting § 251(g)). And it found that calls made to ISPs located within the caller's local calling area fall within those enumerated categories—speci-

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[2] Section 251(g) provides, in relevant part:

> On and after [the date of enactment of the Telecommunications Act of 1996], each local exchange carrier . . . shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding [the date of enactment] under any . . . regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after [the date of enactment].

47 U.S.C. § 251(g).

fically, that they constitute "information access." *Id.* at 9171, ¶ 42. Those calls, the FCC concluded, are thus not subject to § 251(b)(5), but are instead subject to the FCC's regulatory authority under § 201. *See id.* at 9152-53, ¶ 1; *id.* at 9165, ¶ 30; *id.* at 9175-81, ¶¶ 52-65.

The FCC next sought "to establish an appropriate cost recovery mechanism for delivery of this [ISP-bound] traffic." *Id.* at 9154, ¶ 4. The Commission concluded that "the existing intercarrier compensation mechanism . . . , in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets." *Id.* at 9153, ¶ 2. And it announced that it was issuing—in tandem with its *ISP Remand Order*—a notice of proposed rulemaking to consider whether the Commission should replace existing intercarrier compensation schemes with a "bill-and-keep" regime. *Id.*; *see Notice of Proposed Rulemaking, Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610, 2001 WL 455872 (2001) ("*NPRM*"). Under such a regime, "neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers [its costs] from its own end-users." *ISP Remand Order*, 16 FCC Rcd at 9153 n.6. Thus, in the typical scenario discussed above, the originating ILEC would recover its costs from the customer who initiated the call, while the CLEC would recover its costs from the ISP customer to which it delivered the call.

Although the FCC issued the NPRM looking toward a bill-and-keep regime, the Commission nonetheless deemed it "prudent" not to switch immediately "to a new compensation regime that would upset the legitimate

business expectations of carriers and their customers." *Id.* at 9186, ¶ 77. It therefore adopted "an interim intercarrier compensation regime for ISP-bound traffic that serves to limit, if not end, the opportunity for regulatory arbitrage, while avoiding a market-disruptive 'flash cut' to a pure bill and keep regime." *Id.* at 9186-87, ¶ 77. The interim regime, the FCC said, "will govern intercarrier compensation for ISP-bound traffic until we have resolved the issues raised in the intercarrier compensation *NPRM*." *Id.* at 9187, ¶ 77. According to the FCC, this would be "a *three-year* interim intercarrier compensation mechanism for the exchange of ISP-bound traffic." *Id.* at 9199, ¶ 98 (emphasis added).

The FCC's interim regime has four provisions particularly relevant to Core. Of these, the most important are the "rate caps," which establish a gradually declining maximum rate that a carrier (typically, a CLEC) can charge another carrier (typically, an ILEC) for delivering a call to an ISP. *Id.* at 9187, ¶ 78. As an adjunct to the rate caps, the Commission also established a "mirroring rule," which provides that the rate caps on ISP-bound traffic apply only if the ILEC also offers to charge the CLEC the same capped rate to terminate local traffic that originates on the CLEC's network. *Id.* at 9193-94, ¶ 89. The other two provisions are "growth caps," which impose a limit on the total number of ISP-bound minutes for which a carrier can receive intercarrier compensation, and a "new markets rule," which denies intercarrier compensation for ISP-bound traffic in markets where the carrier was "not exchanging traffic pursuant to [an] interconnection agreement[] prior to adoption" of the Order. *Id.* at 9191, ¶ 86; *id.* at 9188-89, ¶ 81. *See generally In re Core*, 455 F.3d at 273-74.

In *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), we reviewed the *ISP Remand Order*. Our opinion, issued on May 3, 2002, rejected the FCC's conclusion that § 251(g) authorizes it to carve out ISP-bound calls from the requirement of § 251(b)(5). *See id.* at 430. "Because that section is worded simply as a transitional device," we held, the FCC cannot rely on § 251(g) to exclude ISP-bound calls from the scope of § 251(b)(5). *Id.* Section 251(g), we said "does not provide a basis for the Commission's action." *Id.* at 434.

This time, however, we did not vacate the FCC's order. Nor did we "address petitioners' attacks on various interim provisions devised by the Commission." *Id.* at 430. Instead, because we thought that there might "well be other legal bases for adopting the rules chosen by the Commission for compensation between the originating and the terminating LECs in calls to ISPs," we merely remanded to the Commission for further proceedings, thus leaving the interim rules in effect. *Id.*; *see id.* at 434.

The Telecommunications Act of 1996 authorizes any telecommunications carrier to petition the FCC to "forbear from applying any regulation or any provision" of the Act. 47 U.S.C. § 160(a). On July 14, 2003, Core filed a petition asking the FCC to forbear from applying the four interim provisions of the *ISP Remand Order*. On October 8, 2004, the Commission granted Core's petition in part and denied it in part. The FCC granted the request to forbear from enforcing the growth caps and new markets rule, but denied Core's petition with respect to the rate caps and mirroring rule. Core then sought review in this court, asking us to reverse the FCC's partial denial of its petition for forbearance. We denied Core's

request and upheld the Commission's decision. *In re Core*, 455 F.3d at 270, 275-80.[3]

Meanwhile, the FCC still had not responded to the *WorldCom* remand. In June 2004, after two years had passed without a response, Core petitioned this court for a writ of mandamus. In its August 2004 response, the FCC argued that mandamus was premature because "Commission staff recently completed and forwarded to the Chairman of the FCC a draft order addressing the *WorldCom* remand." Resp. of FCC to Pet. for Writ of Mandamus at 1 (Aug. 19, 2004). It further argued that the delay was "not as long as the egregious delays that historically have been found to warrant mandamus relief." *Id.* at 11 (internal quotation marks omitted). "When this Court has found the mandamus remedy to be appropriate," the FCC stated, "it generally has been confronted with delays of at least three years." *Id.*

Based on this response, we deferred consideration of the mandamus petition and directed the FCC to advise us, at 90-day intervals, "of its progress in responding to the remand in *WorldCom*." *In re Core Commc'ns, Inc.*, No. 04-1179 (D.C. Cir. Nov. 22, 2004). On March 4, 2005, FCC counsel reported that the Commission had just released a "Further Notice of Proposed Rulemaking [FNPRM] in the *Intercarrier Compensation* docket in which it has been seeking, among other things, to adopt permanent rules to succeed the interim intercarrier compensation regime for Internet-bound traffic that this Court reviewed in *WorldCom, Inc. v. FCC*." Supp. Status Report at 1 (Mar. 4, 2005). Based on the FCC's representations regarding the draft order and FNPRM, we

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[3] In the same opinion, we also denied a request by a group of ILECs to reverse the FCC's partial grant of Core's forbearance petition. *In re Core*, 455 F.3d at 270, 280-83.

denied Core's mandamus petition in May 2005, "without prejudice to refiling in the event of significant additional delay." *In re Core Commc'ns, Inc.*, No. 04-1179 (D.C. Cir. May 24, 2005).

A year later, in April 2006, there was no word from the FCC on the fate of the draft *WorldCom* order and no release of permanent rules in response to the FNPRM. Core then filed a second forbearance petition with the Commission, again asking, among other things, for the FCC to forbear from applying the (remaining) interim rules that carve out ISP-bound traffic from the obligation to pay reciprocal compensation. The Commission rejected Core's petition, *Petition of Core Communications, Inc. for Forbearance from Sections 251(g) and 254(g) of the Communications Act and Implementing Rules*, 22 FCC Rcd 14,118, 2007 WL 2159638 (2007),[4] and Core has appealed that decision. The case is currently on this circuit's docket.

In October 2007, Core filed its second mandamus petition, which is now before us. It asks that we compel the FCC to enter an order, within 60 days, responding to our *WorldCom* remand with an explanation of the legal basis for the rules that exclude ISP-bound calls from the reciprocal compensation requirement of § 251(b)(5). Core further requests that we vacate those rules if the FCC does not issue such an order.

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[4] The FCC also disagreed with Core's contention that forbearance would return ISP-bound traffic to a reciprocal compensation regime, stating that, if "the Commission were to forbear from the rate regulation preserved by section 251(g), there would be no rate regulation governing the exchange of traffic currently subject to the access charge regime." 22 FCC Rcd at 14,126, ¶ 14.

II

Core seeks a writ of mandamus under the All Writs Act, 28 U.S.C. § 1651(a), to "compel agency action unlawfully withheld or unreasonably delayed," 5 U.S.C. § 706(1) (Administrative Procedure Act). This court's jurisdiction and authority to grant that request are undisputed.[5] Our consideration of any mandamus petition "starts from the premise that issuance of the writ is an extraordinary remedy, reserved only for the most transparent violations of a clear duty to act." *In re Bluewater Network*, 234 F.3d 1305, 1315 (D.C. Cir. 2000). There is, of course, no doubt that the FCC has a "clear duty" to respond to our *WorldCom* remand. "In the case of agency inaction," however, "we not only must satisfy ourselves that there indeed exists such a duty, but that the agency has 'unreasonably delayed' the contemplated action." *Id.* (quoting 5 U.S.C. § 706(1)). The central question in evaluating "a claim of unreasonable delay" is "whether the agency's delay is so egregious as to warrant mandamus." *Telecommunications Research & Action Ctr. v.*

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[5] *See Telecommunications Research & Action Ctr. v. FCC ("TRAC")*, 750 F.2d 70, 75 (D.C. Cir. 1984) ("[T]he statutory commitment of review of FCC action to the Court of Appeals, read in conjunction with the All Writs Act, affords this court jurisdiction over claims of unreasonable Commission delay." (citation omitted)); *id.* at 79 ("Congress has instructed statutory review courts to compel agency action that has been unreasonably delayed. 5 U.S.C. § 706(1)."); *see also In re American Rivers & Idaho Rivers United*, 372 F.3d 413, 414 (D.C. Cir. 2004); *In re Bluewater Network*, 234 F.3d 1305, 1315 (D.C. Cir. 2000); *In re United Mine Workers of Am. Int'l Union*, 190 F.3d 545, 549 (D.C. Cir. 1999). *See generally* 28 U.S.C. § 1651(a) ("The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.").

FCC ("TRAC"), 750 F.2d 70, 79 (D.C. Cir. 1984). We consider that question below.

A

"There is no per se rule as to how long is too long to wait for agency action." *In re American Rivers & Idaho Rivers United*, 372 F.3d 413, 419 (D.C. Cir. 2004). In *TRAC*, we outlined six factors relevant to the analysis. We cautioned that those factors are not "ironclad," but rather are intended to provide "useful guidance in assessing claims of agency delay." *TRAC*, 750 F.2d at 80. The first and most important factor is that "the time agencies take to make decisions must be governed by a 'rule of reason.'" *Id.* The remaining five are:

> (2) where Congress has provided a timetable or other indication of the speed with which it expects the agency to proceed in the enabling statute, that statutory scheme may supply content for this rule of reason; (3) delays that might be reasonable in the sphere of economic regulation are less tolerable when human health and welfare are at stake; (4) the court should consider the effect of expediting delayed action on agency activities of a higher or competing priority; (5) the court should also take into account the nature and extent of the interests prejudiced by delay; and (6) the court need not "find any impropriety lurking behind agency lassitude in order to hold that agency action is 'unreasonably delayed.'"

In re United Mine Workers of Am. Int'l Union, 190 F.3d 545, 549 (D.C. Cir. 1999) (quoting *TRAC*, 750 F.2d at 80).

Both Core and the FCC dutifully address the six *TRAC* factors individually, each party drawing different conclusions. *See* Pet'r Br. 19-27; FCC Br. 13-23. But while those factors are not unimportant here, we must

begin by noting that the procedural posture of this case is different from that of most of this circuit's unreasonable delay cases. *TRAC*, and all of the cases cited by the parties that employ its methodology, involved delay by agencies in concluding their own rulemakings or in responding to requests by private parties to take administrative action.[6] The problem that confronts us here is different. In this case, we are faced with the agency's failure—for six years—to respond to our own remand. In so doing, the agency has effectively nullified our determination that its interim rules are invalid, because our remand without vacatur left those rules in place. Moreover, until the FCC states its explanation for its interim rules in a final order, Core cannot mount a challenge to those rules. In this way, the FCC insulates its nullification of our decision from further review. But a federal court has authority to issue a writ of mandamus to "prevent the frustration of orders previously issued." *Potomac Elec. Power Co. v. ICC ("PEPCO")*, 702 F.2d 1026, 1032 (D.C. Cir. 1983). And "[b]ecause the statutory obligation of a Court of Appeals to review on the merits may be defeated by an agency that fails to resolve disputes, a Circuit Court may resolve claims of unreasonable delay in order to protect its future jurisdiction." *TRAC*, 750 F.2d at 76; *see American Rivers*, 372 F.3d at 419 ("[T]he primary purpose of the writ in circumstances like these is to ensure that an agency does not thwart [the court's] jurisdiction by withholding a reviewable decision.").

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[6] *See, e.g., American Rivers*, 372 F.3d 413; *Mashpee Wampanoag Tribal Council, Inc. v. Norton*, 336 F.3d 1094 (D.C. Cir. 2003); *United Mine Workers*, 190 F.3d 545; *Action on Smoking & Health v. Department of Labor*, 100 F.3d 991 (D.C. Cir. 1996); *In re Barr Labs.*, 930 F.2d 72 (D.C. Cir. 1991); *In re Monroe Commc'ns Corp.*, 840 F.2d 942 (D.C. Cir. 1988).

Two precedents are most relevant to our disposition of this case. The first is *PEPCO*, 702 F.2d 1026, a pre-*TRAC* case in which we held that the ICC had unreasonably delayed the disposition of PEPCO's challenge to the lawfulness of railroad freight charges. Five years earlier we had remanded PEPCO's challenge to the Commission for further consideration, in response to which the Commission reopened the proceedings, then began an entirely new hearing, and then reopened the proceedings again. *Id.* at 1029-30. Relying on "our inherent power to construe the mandate of our earlier decision," we reviewed the "question whether PEPCO's right to a timely decision from the Commission ha[d] been violated." *Id.* at 1032. We concluded that it had. Noting that "[a]gain and again the Commission has promised to expedite this matter, but without delivering," we ordered the Commission to reach a final decision on PEPCO's challenge within 60 days. *Id.* at 1035.

The second precedent is *Radio-Television News Directors Ass'n v. FCC*, 229 F.3d 269 (D.C. Cir. 2000), a case that cites *TRAC* but does not address its six factors individually. *See id.* at 272. *Radio-Television* began as a challenge to the FCC's personal attack and political editorial rules, which had been the subject of a petition to rescind since 1980. In 1997, the Commission decided (by an equally divided vote) not to repeal the rules, but it offered no affirmative justification for that decision. On appeal in 1999, we held that, "[w]ithout a clear explanation for the rules, the court is not in a position to review whether they continue to serve the public interest." *Radio-Television News Dirs. Ass'n v. FCC*, 184 F.3d 872, 875 (D.C. Cir. 1999). "Accordingly, rather than enjoining enforcement of existing rules that the FCC might be able to justify," we "remand[ed] the case for the FCC to fur-

ther explain its decision not to repeal or modify them." *Id.* That, we said, would put the court "in a position to test the FCC's rationale" should "a further challenge be made to the FCC's decision on remand." *Id.*

Nine months later, the FCC had taken no action, and the petitioners filed a petition for mandamus. The FCC responded by issuing an order temporarily suspending the rules for 60 days. That order, we held, was "not responsive to the court's remand." *Radio-Television*, 229 F.3d at 271. It did not provide a justification for the rules, and "simply ha[d] the effect of further postponing a final decision by the Commission." *Id.* Noting that "[t]he court has afforded repeated opportunities for the Commission to take final action," and that "[d]espite its filings suggesting to the court that something would happen, the Commission, once again, has done nothing to cure the deficiencies of which it has been long aware," we issued "a writ of mandamus directing the Commission immediately to repeal the personal attack and political editorial rules." *Id.* at 272.

The similarities between *PEPCO* and *Radio-Television* on the one hand, and this case on the other, are clear. It is now seven years since the FCC put in place the interim rules that it said would last only three. It is now six years since we held, for the second time, that the FCC's legal justification for the rules was invalid and remanded for the agency to provide a valid justification. During all this time, the FCC has proceeded—as it did in *PEPCO* and *Radio-Television*—to enforce rules for which it has articulated no lawful basis. In *PEPCO*, we issued the writ when the ICC failed to respond to our

remand within five years. In *Radio-Television*, we did so when the FCC failed to respond within just nine months.[7]

As noted above, the first *TRAC* factor is that "the time agencies take to make decisions must be governed by a 'rule of reason.'" *TRAC*, 750 F.2d at 80. *PEPCO* and *Radio-Television* make clear that the FCC's delay in responding to our *WorldCom* remand is anything but reasonable, and that factor is decisive here. Indeed, we have several times found similar delays unreasonable even when the requests for action came from private parties. For example, in *MCI Telecommunications Corp. v. FCC*, 627 F.2d 322 (D.C. Cir. 1980), from which *TRAC* derived its "rule of reason" standard, we found the FCC's four-year delay in determining a just and reasonable tariff to be unreasonable. *Id.* at 325. And in *American Rivers*, we found that FERC's delay of six years in responding to a petition was "nothing less than egregious." 372 F.3d at 419.[8]

In the words of the fifth *TRAC* factor, it is also clear that Core has been "prejudiced by delay." *TRAC*, 750 F.2d at 80. For seven years—since the *ISP Remand Order* established the interim rules—Core has been

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[7] Although our remand in *Radio-Television* had expressly stated that "the FCC need act expeditiously," 184 F.3d at 889, timeliness is implicit in every remand by this court, *see PEPCO*, 702 F.2d at 1034 ("[O]ur remand in the earlier appeal to this court implicitly included the understanding that the Commission would respond to our mandate in a timely manner."); *cf.* 47 U.S.C. § 402(h) (providing that, on remand from this court, "it shall be the duty of the Commission . . . to *forthwith give effect*" to the judgment of the court (emphasis added)).

[8] *See also Air Line Pilots Ass'n, Int'l v. Civil Aeronautics Bd.*, 750 F.2d 81, 86 (D.C. Cir. 1984) (finding a five-year delay unreasonable); *Public Citizen Health Research Group v. Auchter*, 702 F.2d 1150, 1157-59 (D.C. Cir. 1983) (finding a three-year delay unreasonable).

subject to rate caps that it estimates "result in rates 300-400% lower than other § 251(b)(5) intercarrier compensation rates." Pet'r Br. 14. It has been subject to those caps notwithstanding that this court has found invalid the only statutory basis the FCC has articulated to support them. The FCC's brief suggests that Core's concerns have less urgency because "[i]ncreasingly, end users are not using dial-up connections to connect to the Internet, but, rather, cable modem, DSL, and other broadband platforms." FCC Br. 17 (emphasis omitted). Perhaps this makes Core's concerns less urgent to the FCC, but it makes them no less urgent to Core. As discussed in Part II.B below, Core is seeking relief not only for the future, but for the period since 2001, when dial-up access to the Internet was not yet as outmoded as the slide rule.

The FCC urges us to stay our hand until the conclusion of its ongoing rulemaking proceeding "in which it is considering comprehensive, industry-wide reforms to the system of intercarrier compensation." FCC Br. 1. "[T]his broad rulemaking," we are told, "will, among other things, address the issues raised by this Court's remand in *WorldCom, Inc. v. FCC*." *Id.* Indeed, counsel suggests that the Commission is on the brink of concluding its rulemaking and responding to our remand. We have heard this refrain before.

Seven years ago, in April 2001, the Commission issued an NPRM that announced its intention to promulgate a comprehensive regime to supersede what it said would be only a "three-year" interim regime under the *ISP Remand Order*. *See NPRM*, 16 FCC Rcd 9610. In August 2004, in response to Core's first mandamus petition, the FCC advised us that "Commission staff recently completed and forwarded to the Chairman of the FCC a draft order addressing the *WorldCom* remand." Resp. of FCC

to Pet. for Writ of Mandamus at 1 (Aug. 19, 2004). In light of this advice, we deferred consideration of the petition and ordered status reports. In its March 2005 status report, the FCC further advised that it had just issued a "Further Notice of Proposed Rulemaking in the *Intercarrier Compensation* docket in which it has been seeking, among other things, to adopt permanent rules to succeed the interim intercarrier compensation regime for Internet-bound traffic that this Court reviewed in *WorldCom, Inc. v. FCC*." Supp. Status Report at 1 (Mar. 4, 2005). On further inspection, it appears that the FNPRM in question contained only a single, footnote reference to the *WorldCom* order: "In this proceeding, the Commission *hopes* to address the compensation regime for all types of traffic, including ISP-bound traffic." *Further Notice of Proposed Rulemaking, Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685, 4694 n.48, 2005 WL 495087 (2005) (emphasis added). Nonetheless, on that hope we denied the petition, "without prejudice to refiling in the event of significant additional delay." *In re Core*, No. 04-1179 (May 24, 2005).

More than three years later, when "significant additional delay" had indeed transpired, Core filed the instant petition. Then, one business day before we heard oral argument in this case, FCC counsel informed us that the Commission had issued an order adopting an interim cap on the support that certain telecommunications carriers can receive from the Universal Service Fund. Quoting a press release from the FCC's Wireline Competition Bureau calling the order "'a crucial first step' toward 'comprehensive reform' not only of Universal Service but also of intercarrier compensation," counsel stated: "Now that the Commission has capped payments from the

fund, the Commission can 'move forward expeditiously on comprehensive reform' of intercarrier compensation." FCC Rule 28(j) Letter, May 2, 2008 (quoting Press Release, FCC, Interim Cap Clears Path for Comprehensive Reform (May 2, 2008)). But the Commission order that the press release touts does not mention comprehensive reform of *intercarrier compensation*, let alone the specific problem of ISP-bound traffic. Rather, it refers only to "comprehensive reform of high-cost universal service support." *High-Cost Universal Service Support*, 45 Commc'ns Reg. (P & F) 1, 3, ¶ 4, 2008 WL 1930572 (2008). And in any event, it is now far too late for the Commission to be taking a "first step," even if it is a "crucial" one.

On the day of oral argument, the FCC made yet another last-minute declaration of imminent action. Counsel informed the court—for the first time—that the Chairman of the FCC had authorized him to represent that "the Chairman fully intends to do everything he can to respond to the *WorldCom* remand within six months." Oral Arg. Recording at 22:18-23:03. The Chairman will attempt, counsel advised, to "achieve broad-based comprehensive intercarrier compensation reform within six months," and "*WorldCom* would be part of that." *Id.* While this representation is welcome, the Chairman's doing "everything he can" may not suffice, as he may not be able to enforce his will on his fellow Commissioners. In any event, the representation is not enforceable unless backed up by issuance of the writ. At some point, promises are no longer enough, and we must end the game of "administrative keep-away." *American Rivers*, 372 F.3d at 420.

In granting the writ of mandamus, we do not second-guess the FCC's policy judgment to pursue a comprehen-

sive solution to the problem of intercarrier compensation. *See Action on Smoking & Health v. Department of Labor*, 100 F.3d 991, 994 (D.C. Cir. 1996). But as we said in *MCI*, in response to a similar plea by the FCC to allow it to continue in effect rates that had been found unsupported pending the issuance of "comprehensive procedures": "[T]here must be some limit to the time tariffs unjustified under the law can remain in effect. . . . Otherwise, the regulatory scheme Congress has crafted becomes anarchic. . . ." 627 F.2d at 325. We are also, as always, "acutely aware of the limits of our institutional competence in [a] highly technical area," *Grand Canyon Air Tour Coal. v. FAA*, 154 F.3d 455, 476 (D.C. Cir. 1998), and loath to "interfere with the agency's internal processes," *United Mine Workers*, 190 F.3d at 553. But what Core asks us to do is neither technical nor intrusive. Core does not ask the FCC to promulgate any particular rule or policy; it asks only that the Commission state the *legal* authority for the current rule that refuses Core the right to reciprocal compensation. Either the FCC has such authority or it does not. If the FCC believes it has authority, it should not take six years to put its rationale in writing. Even if the Commission ultimately decides to include ISP-bound traffic in a more comprehensive scheme, it still must have statutory authority to do so. *See, e.g., FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161, 120 S. Ct. 1291, 146 L. Ed. 2d 121 (2000) ("[A]n administrative agency's power to regulate . . . must always be grounded in a valid grant of authority from Congress."). Stating that rationale now should not impede the FCC's broader rulemaking project.

B

The FCC urges us, in the event we do not reject Core's mandamus request outright, to defer a final

resolution until this circuit rules on Core's appeal of the FCC's denial of its second forbearance petition. In that petition, Core asked the FCC to forbear from applying the interim rules that cap its compensation. On appeal, Core intends to argue not only that its forbearance petition should have been granted, but that it was "deemed granted" by operation of law because the FCC did not deny the petition until after the statutory deadline had passed. *See* 47 U.S.C. § 160(c) (providing that any forbearance petition "shall be deemed granted if the Commission does not deny" it within the specified time period). Core further intends to argue that, as a consequence, compensation for ISP-bound traffic is no longer governed by the interim intercarrier compensation rules, but is instead governed by § 251(b)(5)'s reciprocal compensation regime.

Although the Commission believes Core's position lacks merit and intends to oppose its appeal of the denial of forbearance, FCC counsel argues that we should defer consideration of mandamus until that appeal is decided. If Core were to prevail in its forbearance appeal, counsel argues, the Commission could no longer apply the interim compensation rules and Core's problem would be solved. Because mandamus is an extraordinary remedy, available only if a party has "no other adequate means to attain the relief [it] desires," *Allied Chem. Corp. v. Daiflon, Inc.*, 449 U.S. 33, 35, 101 S. Ct. 188, 66 L. Ed. 2d 193 (1980), the FCC contends that we should not consider issuing the writ unless and until the alternative of a forbearance appeal is foreclosed.

But Core's appeal of the denial of forbearance is not an adequate means to attain the relief it seeks. As Core explains, forbearance offers only prospective relief: forbearance by the Commission "from applying" the in-

terim rules in the future. 47 U.S.C. § 160(a). Core, however, seeks retroactive relief as well. In the late 1990s—prior to the FCC's carve-out of ISP-bound traffic—Core entered into contracts with various ILECs that provided reciprocal compensation for the ISP-bound traffic that Core terminated. The *ISP Remand Order* capped Core's compensation at lower levels.

Core maintains that only the grant of a writ of mandamus will make it whole by making retroactive relief available. If we compel the FCC to state its legal justification for the interim rules, and if that justification is not forthcoming or is invalid, we will vacate those rules. Core argues that this will mean there never was any lawful justification for the caps on its compensation: i.e., that "the FCC has enforced an *ultra vires* compensation regime since 2001." Pet'r Reply Br. 2. And that result, Core contends, will entitle it to retroactive compensation under its pre-existing contracts with the ILECs. FCC counsel does not deny this contention, saying only that it is a "very complex question . . . which I can't really speak to." Oral Arg. Recording at 20:33. We thus cannot conclude that Core's appeal of the FCC's denial of forbearance offers an adequate alternative means of attaining the relief Core desires.

We also note that the resolution of an appeal from the FCC's denial of forbearance regarding the interim compensation rules will not vindicate this court's own interest in seeing that its mandate is honored. That mandate was to explain the legal basis for those rules so that their validity could ultimately be evaluated. An appeal from the denial of forbearance, by contrast, looks at the reasonableness of the FCC's determination of three quite

different issues.[9] The additional point Core intends to raise, that its petition must be "deemed granted" pursuant to 47 U.S.C. § 160(c), is likewise unrelated to the FCC's legal authority for its interim intercarrier compensation scheme.

C

There remains only the question of the content of the writ that we will issue. Core asks us to direct the FCC to promulgate an order that explains the statutory authority for its interim rules, and to vacate those rules if the FCC does not issue such an order within 60 days. Although Core urges us to impose a 60-day deadline, it is clear that obtaining a fixed deadline is Core's foremost concern. Oral Arg. Recording at 28:56-29:35.

As we noted above, in an effort to stave off Core's request, FCC counsel represented that the Commission's Chairman intends to achieve comprehensive intercarrier compensation reform within six months. Such reform, counsel advised, would include a response to our *WorldCom* remand. We will give the Chairman a chance to meet that schedule, and will direct the Commission to

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[9] The Telecommunications Act requires the FCC to "forbear from applying any regulation or any provision [of the Act] . . . to a telecommunications carrier or telecommunications service" if it determines that:

> (1) enforcement of such regulation or provision is not necessary to ensure that the . . . regulations . . . in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.

47 U.S.C. § 160(a); *see In re Core*, 455 F.3d at 277.

issue its explanation by November 5, 2008—six months from the day that representation was made.

We agree with Core, however, that this must be the end of the Commission's delay. The first time we determined that the rationale for the rules was invalid, in *Bell Atlantic*, we vacated as well as remanded. 206 F.3d at 9. In less than a year, the FCC issued a new order with a new rationale. When we concluded in *WorldCom* that the FCC's second rationale was also invalid, we plainly had authority to vacate again. *See* 5 U.S.C. § 706 (stating that a reviewing court shall "set aside" agency action found to be "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right"); *see also Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150-51 (D.C. Cir. 1993). Instead, we chose only to remand, believing that there was a "non-trivial likelihood" that the Commission would be able to state a valid legal basis for its rules. *WorldCom*, 288 F.3d at 434; *see Allied-Signal*, 988 F.2d at 151 (noting that, when there is a "serious possibility that the Commission will be able to substantiate its decision on remand," we may remand without vacating). This time, there was no prompt response—only six years of promises and further delay.

Having repeatedly, and mistakenly, put our faith in the Commission, we will not do so again. If the FCC cannot, within six months, explain its legal authority for the interim rules, we can only presume that this is because there is in fact no such authority. Under those conditions, vacatur is indicated. *See Allied-Signal*, 988 F.2d at 150-51. Accordingly, the rules will be vacated on November 6, 2008, unless the court is notified that the Commission has complied with our direction before that date.

III

For the foregoing reasons, we grant the writ of mandamus and direct the FCC to respond to our 2002 *WorldCom* remand by November 5, 2008. That response must be in the form of a final, appealable order that explains the legal authority for the Commission's interim intercarrier compensation rules that exclude ISP-bound traffic from the reciprocal compensation requirement of § 251(b)(5). No extensions of this deadline will be granted. The rules are hereby vacated on November 6, 2008, unless the court is notified that the Commission has complied with our direction before that date. This panel of the court will retain jurisdiction over the case to ensure compliance with our decision. *See MCI*, 627 F.2d at 325.

So ordered.

GRIFFITH, Circuit Judge, concurring:

I join the court's well-reasoned opinion. The circumstances that occasion today's decision lead me to question the wisdom of the open-ended remand without vacatur. In *WorldCom, Inc. v. FCC*, we opted for such a remedy after concluding that the Federal Communications Commission ("FCC") had issued an order without establishing statutory authorization. 288 F.3d 429, 434 (D.C. Cir. 2002). The FCC ignored our request for a better explanation of its statutory authority, and six years later we are forced to clean up a mess we helped create. There is a lesson here.

Remand without vacatur is common in this circuit, especially after our decision in *Allied-Signal, Inc. v. U.S. Nuclear Regulatory Commission*, 988 F.2d 146, 150-51 (D.C. Cir. 1993). But experience suggests that this remedy sometimes invites agency indifference. *See Natural Res. Def. Council v. EPA*, 489 F.3d 1250, 1262-64 (D.C.

Cir. 2007) (Randolph, J., concurring) ("A remand-only disposition is, in effect, an indefinite stay of the effectiveness of the court's decision and agencies naturally treat it as such."); Kristina Daugirdas, Note, *Evaluating Remand Without Vacatur: A New Judicial Remedy for Defective Agency Rulemakings*, 80 N.Y.U.L. REV. 278, 301-05 (2005) (describing instances of multi-year delay). Today's decision is a case in point. After waiting in vain for the FCC to respond to *WorldCom* of its own volition, we are forced to resort to the "extraordinary remedy" of mandamus to compel the agency to act. *In re Bluewater Network*, 234 F.3d 1305, 1315 (D.C. Cir. 2000). I join in today's decision to break out the big stick, but I hope that in the future we will take greater care to avoid putting ourselves in situations where doing so is necessary.

In writing separately, I do not address the disputed legality of remand without vacatur under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A). *Compare Checkosky v. SEC*, 23 F.3d 452, 462-66 (D.C. Cir. 1994) (separate opinion of Silberman, J.) (declaring the practice lawful), *and Sugar Cane Growers Co-op. v. Veneman*, 289 F.3d 89, 98 (D.C. Cir. 2002) (same), *with Checkosky*, 23 F.3d at 490-93 (separate opinion of Randolph, J.) (declaring the practice unlawful), *and Milk Train, Inc. v. Veneman*, 310 F.3d 747, 758 (D.C. Cir. 2002) (Sentelle, J., dissenting) (same). I simply urge future panels to consider the alternatives to the open-ended remand without vacatur. *See, e.g., A.L. Pharma, Inc. v. Shalala*, 62 F.3d 1484, 1492 (D.C. Cir. 1995) (remanding without vacatur but ordering a rule "vacated automatically" absent adequate justification from the agency within 90 days); *Rodway v. USDA*, 514 F.2d 809, 817-18 (D.C. Cir. 1975) (remanding without vacatur but ordering "complet[ion of] the new rule-making process within 120 days of the

issuance of this opinion"); *Cement Kiln Recycling Coal. v. EPA*, 255 F.3d 855, 872 (D.C. Cir. 2001) (per curiam) (vacating regulations but inviting "a motion to delay issuance of the mandate"); *Honeywell Int'l, Inc. v. EPA*, 374 F.3d 1363, 1374-75 (D.C. Cir. 2004) (Randolph, J., concurring) ("It is easy to forget that when we vacate and remand, as we are doing here, there will be a safety valve. The agency, and any intervenors on its side, will have the opportunity to file post-decision motions demonstrating why an unlawful order or rule should remain in place during proceedings on remand.") (citing *U.S. Tel. Ass'n v. FCC*, 188 F.3d 521, 531 (D.C. Cir. 1999)).

APPENDIX D
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

NOS. 04-1368, 04-1423, 04-1424

IN RE: CORE COMMUNICATIONS, INC.,
Petitioner,

LEVEL 3 COMMUNICATIONS, LLC, ET AL.,
Intervenors.

ARGUED OCT. 27, 2005
DECIDED JUNE 30, 2006

Before: SENTELLE, TATEL, and GARLAND, Circuit Judges.

Opinion for the Court filed by Circuit Judge GARLAND.

GARLAND, Circuit Judge:

In its *ISP Remand Order*, the Federal Communications Commission (FCC) adopted four interim, intercarrier compensation rules to govern telecommunications traffic bound for Internet service providers. Core Communications, Inc., a competitive local exchange carrier, filed a petition asking the FCC to forbear from applying those rules pursuant to 47 U.S.C. § 160(a). The FCC denied Core's petition with respect to two of the rules and granted it with respect to the other two. Core then filed a petition for review in this court, seeking reversal of the FCC's partial denial of its petition for forbearance.

We consolidated Core's petition for review with its mirror image: a petition for review filed by BellSouth Corporation, an incumbent local exchange carrier, seeking reversal of the FCC's partial grant of Core's petition for forbearance. For the reasons discussed below, we now deny both petitions.

I

Before high-speed broadband connections (such as cable modem and digital subscriber line (DSL) service) became widely available, consumers generally gained access to the Internet through "dial-up" connections provided by local telephone companies. Under the dial-up method, a consumer uses a line provided by a local exchange carrier (LEC)—usually an incumbent local exchange carrier (ILEC)—to dial the local telephone number of an Internet service provider (ISP), which then connects the call to the Internet. Typically, the ISP does not subscribe to the ILEC, but instead subscribes to another LEC—a competitive local exchange carrier (CLEC)—that interconnects with the incumbent. Accordingly, a consumer who dials-up to the Internet usually obligates an originating ILEC to transfer the call to a CLEC, which then delivers the call to the ISP.

Although this relay is imperceptible to the caller, how the call is paid for matters a great deal to the participating telecommunications carriers. Section 251(b)(5) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (the "Act"), requires LECs to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). Under a reciprocal compensation arrangement, "[w]hen a customer of carrier A makes a local call to a customer of carrier B, and carrier B uses its facilities to connect, or 'terminate,' that call to its own

customer, the 'originating' carrier A is ordinarily required to compensate the 'terminating' carrier B for the use of carrier B's facilities." *SBC Inc. v. FCC*, 414 F.3d 486, 490 (3d Cir. 2005) (citing *Global NAPs, Inc. v. FCC*, 247 F.3d 252, 254 (D.C. Cir. 2001)).

If ISP-bound traffic were governed by § 251(b)(5), then reciprocal compensation arrangements would be required for the ILEC-to-CLEC hand-off described above, and ILECs would be required to compensate CLECs for completing their customers' calls to ISPs. Whether ISP-bound traffic is so governed is a question that has been the subject of two prior FCC orders and two prior decisions of this court. We briefly recount that history and then describe Core's subsequent petition for forbearance.

A

In 1996, the FCC construed the "reciprocal compensation arrangements" provision of § 251(b)(5) to "apply only to traffic that originates and terminates within a local area." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16013, ¶ 1034, 1996 WL 452885 (1996). Although that initial pronouncement did not address whether dial-up calls to an ISP for connection to the Internet are local or non-local, the Commission concluded in its 1999 *Declaratory Ruling* that such calls are non-local, and thus that § 251(b)(5) is inapplicable. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689, 1999 WL 98037 (1999) ("*Declaratory Ruling*"). Instead, the FCC concluded that ISP-bound calls constitute interstate traffic, subject to FCC jurisdiction under § 201 of the

Act.[1] *See id.* at 3690, ¶ 1; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9152, ¶ 1, 2001 WL 455869 (2001) ("*ISP Remand Order*") (construing the *Declaratory Ruling*). In *Bell Atlantic Telephone Cos. v. FCC*, however, this court found that the Commission had inadequately explained its conclusion that ISP-bound traffic is non-local, and therefore vacated and remanded the *Declaratory Ruling*. *See* 206 F.3d 1, 7-8 (D.C. Cir. 2000).

In 2001, the FCC responded to our decision in *Bell Atlantic* with the *ISP Remand Order*. Once again, the Commission concluded that calls delivered to ISPs are not subject to the mandatory reciprocal compensation obligations of § 251(b)(5). *See ISP Remand Order*, 16 FCC Rcd at 9154, ¶ 3. Rather than basing its conclusion on a determination that ISP-bound calls are non-local and hence not subject to § 251(b)(5), this time the Commission relied on a different statutory section, 47 U.S.C. § 251(g).[2] *See id.* at 9153, ¶ 1. According to the FCC,

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[1] Section 201 provides, in relevant part:

> (a) It shall be the duty of every common carrier engaged in interstate . . . communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission . . . finds such action necessary or desirable in the public interest, to establish . . . charges applicable thereto and the divisions of such charges . . . .
>
> (b) All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful . . . .

47 U.S.C. § 201.

[2] Section 251(g) provides, in relevant part:

§ 251(g) was intended to exclude the kinds of traffic enumerated in that subsection, specifically "'exchange access, information access, and exchange services for such access,'" from the reciprocal compensation requirements of subsection (b)(5). *Id.* at 9166-67, ¶ 34 (quoting § 251(g)). And it found that calls made to ISPs located within the caller's local calling area fall within those enumerated categories—specifically, that they involve "information access." *Id.* at 9171, ¶ 42; *see Bell Atlantic*, 206 F.3d at 2. Those calls, the FCC concluded, are thus not subject to § 251(b)(5), but are instead subject to the FCC's regulatory authority under § 201. *See id.* at 9152-53, ¶ 1; *id.* at 9165, ¶ 30; *id.* at 9175-81, ¶¶ 52-65; *see also supra* note 1 (quoting § 201).

Having concluded "that intercarrier compensation for ISP-bound traffic is within the jurisdiction of th[e] Commission under section 201 of the Act," the FCC sought "to establish an appropriate cost recovery mechanism for delivery of this traffic." *Id.* at 9154, ¶ 4. In considering the possible alternatives, the FCC noted that "the existing intercarrier compensation mechanism . . . , in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory

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> On and after [the date of enactment of the Telecommunications Act of 1996,] each local exchange carrier . . . shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding [the date of enactment] under any . . . regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after [such date of enactment].

47 U.S.C. § 251(g).

arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets." *Id.* at 9153, ¶ 2. The FCC explained the different considerations attendant to traditional telephone service and Internet dial-up in this way:

> Traditionally, telephone carriers would interconnect with each other to deliver calls to each other's customers. It was generally assumed that traffic back and forth on these interconnected networks would be relatively balanced. Consequently, to compensate interconnecting carriers, mechanisms like reciprocal compensation were employed, whereby the carrier whose customer initiated the call would pay the other carrier the costs of using its network.
>
> [ ]Internet usage has distorted the traditional assumptions because traffic to an ISP flows exclusively in one direction, creating an opportunity for regulatory arbitrage and leading to uneconomical results. Because traffic to ISPs flows one way, so does money in a reciprocal compensation regime. It was not long before some LECs saw the opportunity to sign up ISPs as customers and collect, rather than pay, compensation because ISP modems do not generally call anyone in the exchange.

Id. at 9162, ¶¶ 20-21. The Commission described the market distortions that result from applying a reciprocal compensation regime to such a "large volume[ ] of traffic that is virtually all one-way—that is, delivered to the ISP," *id.* at 9153, ¶ 2, as follows:

> Because intercarrier compensation rates do not reflect the degree to which the carrier can recover costs from its end-users, payments from other car-

> riers may enable a carrier to offer service to its customers at rates that bear little relationship to its actual costs . . . . Carriers thus have the incentive to seek out customers, including but not limited to ISPs, with high volumes of incoming traffic that will generate high reciprocal compensation payments. To the extent that carriers offer these customers below cost retail rates subsidized by intercarrier compensation, these customers do not receive accurate price signals. Moreover, because the originating LEC typically charges its customers averaged rates, the originating end-user receives inaccurate price signals as the costs associated with the intercarrier payments are recovered through rates averaged across all of the originating carriers' end users.

Id. at 9182, ¶ 68 (internal citations omitted). "For these reasons," the Commission concluded, "we believe that the application of . . . reciprocal compensation[ ] to ISP-bound traffic undermines the operation of competitive markets." *Id.* at 9183, ¶ 71.

After concluding that a reciprocal compensation mechanism results in market distortions, the FCC announced that it was issuing—in tandem with its *ISP Remand Order*—a notice of proposed rulemaking to consider whether the Commission should replace existing intercarrier compensation schemes with a "bill-and-keep" regime. *Id.* at 9153, ¶ 2; *see Notice of Proposed Rulemaking, In the Matter of Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610, 2001 WL 455872 (2001) ("*NPRM*"). Under such a regime, "neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers [its costs] from its own

end-users." *Id.* at 9153 n.6. Thus, in the typical scenario discussed above, the originating ILEC would recover its costs from its customer who initiated the call, while the CLEC would recover its costs from its ISP customer to which it delivered the call. The Commission concluded "that a bill and keep regime for ISP-bound traffic may eliminate the[] incentives and concomitant opportunity for regulatory arbitrage by forcing carriers to look only to their ISP customers, rather than to other carriers, for cost recovery. As a result, the rates paid by ISPs and, consequently, their customers should better reflect the costs of services to which they subscribe." *Id.* at 9184, ¶ 74.

Although the FCC issued the *NPRM* looking toward a bill-and-keep regime, the Commission nonetheless deemed it "prudent to avoid a 'flash cut' to a new compensation regime that would upset the legitimate business expectations of carriers and their customers." *Id.* at 9186, ¶ 77. It therefore adopted "an interim intercarrier compensation regime for ISP-bound traffic that serves to limit, if not end, the opportunity for regulatory arbitrage, while avoiding a market-disruptive 'flash cut' to a pure bill and keep regime." *Id.* at 9186-87, ¶ 77. The interim regime, the FCC said, "will govern intercarrier compensation for ISP-bound traffic until we have resolved the issues raised in the intercarrier compensation *NPRM*." *Id.* at 9187, ¶ 77. Four provisions of the interim regime are relevant to the instant matter:

Rate Caps. The Commission adopted "rate caps," which established a gradually declining maximum rate that a carrier (typically, a CLEC) could charge another carrier (typically, an ILEC) for delivering a call to an ISP. *See id.* at 9187, ¶ 78. Although the rate caps limited how much carriers could recover from other carriers, the

carriers remained free to recover "[a]ny additional costs . . . from end-users," that is, from their own customers. *Id.* at 9156, ¶ 4; *see id.* at 9187, ¶ 78; *see also Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, 19 FCC Rcd 20179, 20181, ¶ 6, 2004 WL 2341235 (2004) ("*Forbearance Order*").

Mirroring Rule. As an adjunct to the rate caps, the Commission established a "mirroring rule," which provided that the rate caps on ISP-bound traffic would apply only if the ILEC also offered to charge the CLEC the same capped rate to terminate local traffic that originated on the CLEC's network. *See ISP Remand Order*, 16 FCC Rcd at 9193, ¶ 89; *see also Forbearance Order*, 19 FCC Rcd at 20181-82, ¶ 8.

Growth Caps. In addition to the rate caps, the Commission adopted "growth caps," which imposed a limit on the total number of ISP-bound minutes for which a carrier could receive intercarrier compensation. *See ISP Remand Order*, 16 FCC Rcd at 9191, ¶ 86. The caps were equal to the total ISP-bound minutes for which the LEC was previously entitled to compensation, plus a 10 percent annual growth factor for each of the first two years under the interim regime. Beyond the caps, ISP-bound traffic had to be exchanged on a bill-and-keep basis. *See id.* at 9156, ¶ 7; *id.* at 9187, ¶ 78; *see also Forbearance Order*, 19 FCC Rcd at 20181, ¶ 7; *id.* at 20187-88, ¶ 24.

New Markets Rule. Finally, the Commission adopted a "new markets rule," which denied intercarrier compensation for ISP-bound traffic in markets where the carrier was "not exchanging traffic pursuant to [an] interconnection agreement[ ] prior to adoption" of the Order. *ISP Remand Order*, 16 FCC Rcd at 9188, ¶ 81. "In such a

case, . . . carriers shall exchange ISP-bound traffic on a bill-and-keep basis during th[e] interim period." *Id.*; *see Forbearance Order*, 19 FCC Rcd at 20182, ¶ 9.

As the FCC explained, these four interim provisions were intended "to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound [traffic] by lowering payments and capping growth." *ISP Remand Order*, 16 FCC Rcd at 9155, ¶ 7. The goal of the interim provisions was "decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users, consistent with the tentative conclusion in the *NPRM* that bill and keep is the appropriate intercarrier compensation mechanism for ISP-bound traffic." *Id.* at 9156, ¶ 7.

We reviewed the *ISP Remand Order* in *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002). There, we rejected the FCC's conclusion that § 251(g) authorized the Commission to carve out ISP-bound calls from the requirements of § 251(b)(5). *See id.* at 430. "Because that section is worded simply as a transitional device," we held, the FCC cannot rely on § 251(g) to exclude ISP-bound calls from the scope of § 251(b)(5). *Id.* Nonetheless, in light of the possibility that there were "other legal bases for adopting the rules chosen by the Commission . . . , we neither vacate[d] the order nor address[ed] petitioners' attacks on various interim provisions devised by the Commission." *Id.* Instead, we merely remanded the matter to the Commission for further proceedings, which left the interim rules in effect pending those proceedings. *See id.* at 434; *see also Forbearance Order*, 19 FCC Rcd at 20182, ¶ 10.

B

The Telecommunications Act of 1996 requires the FCC to "forbear from applying any regulation or any provision" of the Act if it makes three determinations that we discuss in detail in Part II.B below. 47 U.S.C. § 160(a). The Act authorizes any telecommunications carrier to submit a petition to the FCC requesting such forbearance. *See id.* § 160(c). The Commission must act upon the petition within one year, subject to its right to extend that deadline by an additional 90 days. *See id.*

On July 14, 2003, Petitioner Core Communications—a CLEC—filed a petition asking the FCC to forbear from applying the four interim provisions of the *ISP Remand Order* discussed above. After receiving the petition, the Commission exercised its authority to extend the one-year deadline by 90 days. That extension moved the deadline to October 11, 2004. On October 8, 2004, the Commission voted to adopt an order granting in part and denying in part Core's petition. In a press release issued on the day of the vote, the FCC announced the outcome of its decision and stated that "[a]n order detailing the FCC's analysis will be forthcoming." Joint Appendix (J.A.) 135.[3] On October 18, 2004, ten days after the vote and seven days after the statutory deadline, the Commission released the text of its *Forbearance Order* addressing Core's forbearance petition. *See* 19 FCC Rcd 20179, 2004 WL 2341235. The *Forbearance Order* stated that it "shall be effective" as of the October 8, 2004 adoption date. *Id.* at 20189, ¶ 30 (capitalization altered).

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[3] The press release also contained the following routine disclaimer: "This is an unofficial announcement of Commission action. Release of the full text of a Commission order constitutes official action." J.A. 135.

As the press release indicated it would, the FCC granted in part and denied in part Core's forbearance petition. The Commission denied Core's petition with respect to the rate caps and mirroring rule, concluding that those provisions remained necessary to avoid "[regulatory] arbitrage and market distortions." *Id.* at 20186, ¶ 18. However, the FCC granted the request to forbear from enforcing the growth caps and new markets rule, concluding that they were no longer needed because "[m]arket developments since 2001 have eased the concerns about growth of dial-up ISP traffic that" had prompted their adoption. *Id.* at 20186, ¶ 20.

We now have before us two petitions for review of the FCC's *Forbearance Order*. Core contends that the FCC should not only have granted forbearance regarding the growth caps and new markets rule, but should also have granted forbearance regarding the rate caps and mirroring rule. A group of ILECs led by BellSouth takes the opposite position. It contends that the FCC should not have granted forbearance from enforcement of any of the provisions, and hence challenges the FCC's decision to forbear from enforcing the growth caps and new markets rule. We consider Core's arguments in Part II and BellSouth's arguments in Part III.

II

Core raises two principal challenges to the FCC's denial of its request to forbear from enforcing the rate caps and mirroring rule. First, Core argues that the FCC issued its denial belatedly, and that under the statute the FCC's tardiness must be regarded as granting the forbearance petition in its entirety. Second, in the event that its first argument fails, Core challenges the denial of

forbearance with respect to the rate caps and mirroring rule as arbitrary and capricious.[4]

A

The second sentence of § 160(c) declares that a petition for forbearance "shall be deemed granted if the Commission does not deny the petition" within one year of receiving it. 47 U.S.C. § 160(c). The third sentence permits the Commission to extend the one-year period by an additional 90 days. *Id.* And the fourth sentence states that the "Commission may grant or deny a petition in whole or in part and shall explain its decision in writing." *Id.* Core asserts that the FCC missed the § 160(c) deadline by not issuing a written order denying its petition until October 18, seven days after the (extended) statutory deadline of October 11. As a consequence, Core insists, its petition for forbearance must be "deemed granted" in full.

The Commission counters that the announcement of its October 8, 2004 vote satisfied the requirement that it "deny the petition" by the statutory deadline, and that

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[4] We reject, without further discussion, Core's suggestion that the denial of forbearance contravenes our decision in *WorldCom*. The *WorldCom* court could not have been clearer in declaring: "[W]e do not decide petitioners' claims that the interim pricing limits imposed by the Commission are inadequately reasoned." 288 F.3d at 434. We also summarily reject Core's suggestion that its forbearance petition asked the FCC to forbear from applying the ISP Remand Order in its entirety—not simply with respect to the four interim provisions that the FCC addressed in its Forbearance Order—and thus that all the unaddressed provisions of the ISP Remand Order are "deemed granted." 47 U.S.C. § 160(c). The only provisions of the ISP Remand Order against which Core mounted arguments under § 160(a)—indeed, the only provisions that Core specifically mentioned at all—were the four interim provisions. See Core's Petition for Forbearance (J.A. 22-35).

therefore the petition may not be "deemed granted." The deadline, the Commission insists, applies only to the denial and not to the separate requirement of a written explanation: "The two sentences in section 160(c) impose separate and independent obligations on the Commission." FCC Br. 18. In any event, the Commission continues, an FCC regulation permits the Commission to "'designate,'" as it did here, "'an effective date that is . . . earlier . . . in time'" than the date upon which an order is released. *Id.* (quoting 47 C.F.R. § 1.103(a)).

Under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), this court would ordinarily accord deference to the Commission's interpretation of a statutory provision like § 160(c). Core contends that no such deference is due here. This contention is based, in part, on the fact that the FCC's interpretation of § 160(c) is contained only in the litigation briefs of FCC counsel, and not in a Commission order. *See generally United States v. Mead Corp.*, 533 U.S. 218, 228, 121 S. Ct. 2164, 150 L. Ed. 2d 292 (2001).

But there is good reason why the FCC did not address the meaning of the statute in an order: Core never raised the issue before the Commission. That fact does not merely create a problem regarding the extent of deference we owe the FCC's statutory interpretation; it creates a problem regarding our authority to review the issue at all. Under 47 U.S.C. § 405(a), the "filing of a petition for reconsideration" is a "condition precedent to judicial review" of any FCC order "where the party seeking such review . . . relies on questions of fact or law upon which the Commission . . . has been afforded no opportunity to pass." 47 U.S.C. § 405(a). This circuit has strictly construed that section, holding that we "generally

lack jurisdiction to review arguments that have not first been presented to the Commission." *BDPCS, Inc. v. FCC*, 351 F.3d 1177, 1182 (D.C. Cir. 2003); *see, e.g., American Family Ass'n, Inc. v. FCC*, 365 F.3d 1156, 1166 (D.C. Cir. 2004); *New England Pub. Commc'ns Council, Inc. v. FCC*, 334 F.3d 69, 79 (D.C. Cir. 2003); *Sioux Valley Rural Television, Inc. v. FCC*, 349 F.3d 667, 676 (D.C. Cir. 2003).

Time Warner Entertainment Co. v. FCC, 144 F.3d 75 (D.C. Cir. 1998), cited by Core, is not to the contrary. That case held that, where "the formulation of the issue presented to us was not precisely as presented to the Commission," we will nonetheless review it if "a reasonable Commission *necessarily* would have seen the question raised before us as part of the case presented to it." 144 F.3d at 81 (emphasis in original); *see AT & T Corp. v. FCC*, 317 F.3d 227, 235 (D.C. Cir. 2003). Core's problem, however, is not that it failed to present the issue to us "precisely" as it presented the issue to the Commission. The problem is that it failed to present the issue to the Commission in any form whatsoever.

Of course, Core, too, had good reason not to address, in its forbearance petition, whether a timely denial of that petition would require a written decision or only the announcement of the Commission's vote: Core could not have known, when it filed the petition, that the FCC would wait to issue its written denial until after the October 11 deadline had passed. Adhering to the language of § 405(a), however, we have held that, even when a petitioner has no reason to raise an argument until the FCC issues an order that makes the issue relevant, the petitioner must file "a petition for reconsideration" with the Commission before it may seek judicial review. 47 U.S.C. § 405(a); *see AT & T Corp. v. FCC*, 86 F.3d 242,

246 (D.C. Cir. 1996). Core did not file such a petition in this case.

None of the foregoing should be understood to place this court's imprimatur on the FCC's actions. Waiting until the eleventh hour to vote on a forbearance petition, and then waiting until the thirteenth hour to issue the explanatory order, is hardly an ideal procedure for notifying a party of the disposition of a petition. And relying on an informal press release and a back-dating regulation to satisfy a statutory deadline could unnecessarily place Commission policies at risk of judicial invalidation. Nonetheless, because Core did not give the Commission an opportunity to address the question, we cannot be the first authority to construe the meaning of § 160(c).

B

We review the Commission's order denying in part Core's petition for forbearance under the familiar "arbitrary and capricious" standard. *See* 5 U.S.C. § 706(2)(A); *Cellular Telecomms. & Internet Ass'n v. FCC*, 330 F.3d 502, 507 (D.C. Cir. 2003); *AT & T Corp. v. FCC*, 236 F.3d 729, 734 (D.C. Cir. 2001). Under that standard, our scope of review "is narrow and a court is not to substitute its judgment for that of the agency." *Cellular Telecomms.*, 330 F.3d at 507. The agency must, however, "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983) (internal quotation marks omitted).

Section 160(a) requires the FCC to "forbear from applying any regulation or provision [of the Act] . . . to a telecommunications carrier or telecommunications service" if it determines that

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; *and*
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.

47 U.S.C. § 160(a) (emphasis added). These three prongs of the forbearance test "are conjunctive," meaning that "[t]he Commission could properly deny a petition for forbearance if it finds that any one of the three prongs is unsatisfied." *Cellular Telecomms.*, 330 F.3d at 509. In this case, the Commission found that "none of the three prongs is satisfied with respect to the rate caps and mirroring rule." *Forbearance Order*, 19 FCC Rcd at 20184, ¶ 15. We now proceed to examine the reasonableness of the FCC's determination.

1. Core does not contend that there has been any change in circumstances since the *ISP Remand Order* rendering enforcement of the rate caps no longer "necessary to ensure that the charges [and] practices" of CLECs serving ISPs "are just and reasonable and are not unjustly or unreasonably discriminatory." 47 U.S.C. § 160(a)(1). Instead, Core challenges the *ISP Remand Order* itself, contending that its imposition of rate caps on ISP-bound traffic was unreasonably discriminatory. It argues that, while "the cost of terminating ISP-bound traffic is the same as any other type of traffic," the FCC has permitted "substantially higher termination rates for other types of traffic, notably long distance traffic." Core Br. 37. "This means," Core explains, "that certain car-

riers earn more revenue for terminating certain types of traffic while other carriers earn less, even though all traffic cost[s] the same." *Id.*

In rejecting this argument, the FCC reasonably concluded that the potential for discrimination *against* ISP-serving CLECs is limited because, as a consequence of the mirroring rule, "the caps apply to ISP-bound traffic only if an incumbent LEC offers to exchange all section 251(b)(5) traffic at the same rate." *Forbearance Order*, 19 FCC Rcd at 20187, ¶ 23. That is, the mirroring rule "prevent[s] disparate treatment of the two types of traffic." *Id.* Moreover, the different characteristics of the two kinds of service—particularly the fact that "traffic to ISPs flows one way, [as] does money in a reciprocal compensation regime," *ISP Remand Order* at 9162, ¶ 21—precludes describing any residual difference in treatment as unreasonably discriminatory. And the FCC further explained that the rate caps are necessary to prevent discrimination *between* dial-up Internet access customers and basic telephone service customers. The rate caps, the FCC stated, "were implemented to prevent the subsidization of dial-up Internet access customers at the expense of consumers of basic telephone service." *Id.* at 20188, ¶ 25.

2. Core makes largely the same argument with respect to the second prong of § 160(a). Enforcement of the rate caps "is not necessary for the protection of consumers," § 160(a)(2), Core argues, because the cost of terminating dial-up Internet traffic and voice traffic is the same. Thus, it contends, "the only way to treat consumers on a nondiscriminatory basis is by enabling all carriers to recover the same termination costs with the same termination rate, such that no consumer has to bear a disproportionate share of network costs." Core Br. 38.

But this argument does not render unreasonable the FCC's view that the rate caps are necessary to prevent the subsidization of dial-up Internet access consumers by consumers of basic telephone service. *See Forbearance Order*, 19 FCC Rcd at 20188, ¶ 25. The FCC does not contend that subsidization arises because the costs of dial-up and voice traffic are different, but rather because "the large one-way flows of cash" in a reciprocal compensation regime "ma[k]e it possible for LECs serving ISPs to afford to pay [the ISPs] to use their services, potentially driving ISP rates to consumers to uneconomical levels." *ISP Remand Order*, 16 FCC Rcd at 9162, ¶ 21; *see id.* at 9182-84, ¶¶ 68-71. Moreover, "because the originating LEC typically charges its customers averaged rates, . . . the costs associated with the intercarrier payments are recovered through rates averaged across all of the originating carrier's end-users," including particularly consumers of regular voice telephone service. *Id.* at 9182, ¶ 68. The FCC concluded that "[t]here is no public policy rationale to support a subsidy running from all users of basic telephone service to those end users who employ dial-up Internet access," *id.* at 9192, ¶ 87, and that the caps were thus necessary to protect consumers of basic telephone service, *see Forbearance Order*, 19 FCC Rcd at 20188, ¶ 25. Core's argument does not undercut the reasonableness of this conclusion.

3. With minor differences, Core reprises the same argument with respect to the third prong of § 160(a), the requirement that "forbearance from applying" the rate caps must be "consistent with the public interest." 47 U.S.C. § 160(a)(3). The caps are inconsistent with that interest, Core insists, because they unreasonably "discriminat[e]" against ISPs, and because they "deter[] investment in competitive networks" by capping the abi-

lity of CLECs to "recover costs at a level materially below the [ILECs'] cost-based rate for providing the same termination function." Core Br. 38. Core derides the FCC's determination that the caps are necessary to prevent "regulatory arbitrage" and "distorted economic incentives" as "nothing more than imprecise, never-defined, FCC econo-babble." *Id.* at 39.

With respect to Core's contention that the rate caps deter investment in competitive telecommunications networks, the FCC found that "Core provide[d] no evidence to support the[ ] claim[ ]." *Forbearance Order*, 19 FCC Rcd at 20185, ¶ 18. Indeed, examination of Core's Petition for Forbearance reveals that the FCC is correct: Core offered no evidence on that issue nor on its broader contention that "the *ISP Remand Order* has forced CLECs from the market." *Core's Petition for Forbearance* 10 (J.A. 33). Core, moreover, cites no such evidence on this appeal.

The derision that Core levels at the FCC's terminology is similarly unwarranted. The FCC's economic analysis is neither imprecise nor undefined. We have quoted it at length in Part I.A to make that clear. In a nutshell, the FCC determined in the *ISP Remand Order* that, because ISP-related traffic flows overwhelmingly in one direction, a reciprocal compensation regime creates an opportunity for CLECs "to sign up ISPs as customers and collect [compensation from], rather than pay [ ] compensation" to, other carriers. *ISP Remand Order*, 16 FCC Rcd at 9162, ¶ 21. In the FCC's view, "this led to classic regulatory arbitrage" that had two negative effects: "(1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-

way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services, potentially driving ISP rates to consumers to uneconomical levels." *Id.* at 9162, ¶ 21.

The question before us is not whether the FCC's economic conclusions are correct or are the ones that we would reach on our own, but only whether they are reasonable. *See Teledesic LLC v. FCC*, 275 F.3d 75, 84 (D.C. Cir. 2001). As we have previously stated, we will not "second-guess" an agency's economic analysis, but will uphold regulations based on such an analysis if the agency "has established in the record a reasonable basis for its decision." *National Wildlife Fed'n v. EPA*, 286 F.3d 554, 566 (D.C. Cir. 2002) (internal quotation marks omitted). Core offers no ground for concluding that the FCC's analysis is unreasonable.

* * * * *

Although Core's petition for review challenged the FCC's denial of forbearance as to both the rate caps and the mirroring rule, Core clarified at oral argument that, if it lost its challenge to the former, it would withdraw its challenge to the latter. *See* Oral Arg. Tr. at 25. That is a logical strategy, since the mirroring rule does no harm to Core and may do it some good: If the rate caps remain in place, the mirroring rule imposes equivalent caps on the rates that an ILEC may charge Core. Having ruled against Core's challenge to the rate caps, we therefore do not address its challenge to the mirroring rule.

III

Taking the opposite tack from Core, the ILECs contend that the FCC acted impermissibly in granting Core's forbearance petition regarding the growth caps and new markets rule. The FCC found that "all three

prongs" of the forbearance standard were met with respect to those provisions. *Forbearance Order*, 19 FCC Rcd at 20184, ¶ 15. Once again, we review the FCC's decision under the arbitrary and capricious standard. *See Cellular Telecomms.*, 330 F.3d at 507.

A

As discussed in Part I.A, the growth caps placed a limit on the total ISP-bound minutes for which a CLEC could receive intercarrier compensation, equal to the total ISP-bound traffic for which the CLEC was previously entitled to compensation, plus a 10% growth factor for each of the first two years of the transition. In the *ISP Remand Order*, the FCC explained that it adopted the measure "to ensure that growth in dial-up Internet access [did] not undermine [FCC] efforts to limit intercarrier compensation for this traffic and to begin, subject to the conclusion of the *NPRM* proceedings, a smooth transition toward a bill and keep regime." *ISP Remand Order*, 16 FCC Rcd at 9191, ¶ 86. "A ten percent growth cap, for the first two years," the FCC stated, "seem[ed] reasonable in light of CLEC projections that the growth of dial-up Internet minutes will fall in the range of seven to ten percent per year." *Id.*

The FCC's new markets rule precluded intercarrier compensation for ISP-bound traffic where the carrier was "not exchanging traffic pursuant to [an] inter-connection agreement[ ] prior to adoption" of the *ISP Remand Order*. *Id.* at 9188, ¶ 81. It applied, for example, "when a new carrier enter[ed] a market or an existing carrier expand[ed] into a market it previously had not served." *Forbearance Order*, 19 FCC Rcd at 20182, ¶ 9. And its purpose, similar to that of the growth caps, was to prevent "expansion of the old compensation regime"

during the transitional period. *ISP Remand Order*, 16 FCC Rcd at 9189, ¶ 81.

The basis for the FCC's decision to grant forbearance from application of the growth caps and new markets rule was the Commission's determination that "[m]arket developments since 2001 have eased the concerns about growth of dial-up ISP traffic that led the Commission to adopt these rules." *Forbearance Order*, 19 FCC Rcd at 20186, ¶ 20; *see id.* at 20186, ¶ 21. "Recent industry statistics indicate . . . declining usage of dial-up ISP services," the Commission noted. *Id.* at 20186, ¶ 20. In particular, the FCC cited an industry report indicating "that the number of end users using conventional dial-up to connect to ISPs is declining as the number of end users using broadband services to access ISPs grows." *Id.* The report showed a decline in the number of dial-up subscribers and forecasted a decline in the percentage of online subscribers using dial-up from 76% in 2002 to 25% in 2008. *See* Bernstein Research Call, DSL Economics I at 1 (Oct. 15, 2003) (J.A. 112). The Commission also cited FCC records showing a ten-fold increase in high-speed access lines between 1999 and 2003. *See* FCC Releases Data on High-Speed Services for Internet Access at Tbl. 1 (June 8, 2004). With reduced concerns regarding "continued expansion of the arbitrage opportunity presented by ISP-bound traffic," *Forbearance Order*, 19 FCC Rcd at 20186, ¶ 20, the Commission concluded that "these concerns are now outweighed by the public interest in creating a uniform compensation regime," *id.* at 20186, ¶¶ 21, and that the public interest prong of § 160(a) was therefore satisfied, *see id.* at 20186-87, ¶¶ 20-21.

The same considerations led the Commission to conclude that the growth caps and new markets rule "are no longer necessary to ensure that charges and practices

are just and reasonable, and not unjustly or unreasonably discriminatory." *Id.* at 20188, ¶ 24 (citing 47 U.S.C. § 160(a)(1)). As the FCC explained, "[b]oth the growth caps and new markets rule require carriers to exchange ISP-bound traffic on a bill-and-keep basis" where the provisions apply, while exchanging traffic under the reciprocal compensation regime (subject to the rate caps) where they do not. *Id.* at 20187-88, ¶ 24. Since the record "failed to demonstrate different costs in delivering traffic that would justify disparate treatment," "similar rates should apply to both local voice traffic and ISP-bound traffic, absent compelling policy reasons to the contrary." *Id.* at 20188, ¶ 24. And because the FCC found that "the policy rationale for those rules no longer outweighs policies favoring a unified compensation regime" in light of the "market developments" just discussed, the Commission "conclude[d] that forbearance is warranted." *Id.* The Commission reached the same conclusion with respect to the "protection of consumers" prong of § 160(a). *Id.* at 20189, ¶ 26.

B

The root of BellSouth's challenge to the FCC's grant of forbearance is an attack on the Commission's determination that market developments have eased the concerns about growth in dial-up usage that initially spurred promulgation of the growth caps and new markets rule.

BellSouth's first claim is that "the record was replete with evidence contradicting" that determination. BellSouth Br. 17. The principal evidence BellSouth cites is one of its own submissions. That submission does not dispute that there has been (and will be) a decline in the number of dial-up *subscribers*; to the contrary, it acknowledges that "the total subscriber base has gradually declined each year since" 2002 and "predicts a loss of 10

million subscribers" in "the next five years." Dial-Up Minutes of Use Chart (Sept. 2004) (J.A. 68). Instead, BellSouth focuses on the submission's projected increase in ISP-bound dial-up *minutes*, a projected increase of 3.5% from 2003 to 2006. *See* BellSouth Br. 17 (citing Dial-Up Minutes of Use Chart (J.A. 68)). That increase, however, still falls well short of the 7-10% projection that initially prompted the FCC to impose the growth caps, and also well below the 10% per year of growth (for each of the first two years) permitted under the caps themselves. *See ISP Remand Order*, 16 FCC Rcd at 9191, ¶ 86. Moreover, the same BellSouth submission that projects a 3.5% increase from 2003 to 2006, predicts a more-than-offsetting decrease of 15.9% from 2006 to 2008 (the last year on the chart). *See* Dial-Up Minutes of Use Chart (J.A. 68).[5]

Shifting from the evidentiary to the theoretical, BellSouth attacks the FCC's prediction that there will be "'declining *usage* of dial-up ISP services'" based on evidence that shows only a decline in "'the number of *end users*.'" BellSouth Br. 19 (quoting *Forbearance Order*, 19 FCC Rcd at 20186, ¶ 20 (emphasis added by BellSouth)).

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[5] BellSouth also cites a submission by Qwest Communications declaring that Quest had experienced a 39% cumulative increase in dial-up minutes in its region from 2001 to 2004, *see* Qwest Letter to FCC at 3 (Oct. 5, 2004) (J.A. 124), and one on behalf of the Independent Telephone & Telecommunications Alliance (ITTA) stating that "dial-up still is the predominant method of ISP access in rural markets," ITTA Letter to FCC at 2 n.2 (Oct. 7, 2004) (J.A. 132). The FCC accurately characterizes these submissions as "anecdotal," "unsupported," and "logically . . . subsumed within the . . . industry-wide results that BellSouth proffered—results that show essentially a plateau in dial-up minutes from 2004 through 2006, with an accelerating decline thereafter." FCC Br. 39. As such, these submissions are insufficient to call into question the reasonableness of the FCC's determination.

This charge is, of course, hobbled from the start by BellSouth's own record submission, which projects a substantial decline in dial-up minutes (i.e., *usage*) by 2008. *See* Dial-Up Minutes of Use Chart (J.A. 68). In any event, "[u]nder the arbitrary and capricious standard of review, 'an agency's predictive judgments about areas that are within the agency's field of discretion and expertise' are entitled to 'particularly deferential' review, as long as they are reasonable." *Milk Industry Found. v. Glickman*, 132 F.3d 1467, 1478 (D.C. Cir. 1998) (quoting *International Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 821-22 (D.C. Cir. 1983)).

There is nothing unreasonable about the FCC's reliance on a declining subscriber base to predict a decline in overall usage of dial-up service. Although BellSouth speculates that increased Internet usage per dial-up subscriber should be expected because such subscribers must remain online longer than broadband users to receive the same content, *see* BellSouth Br. 19, BellSouth cites nothing in the record to support that speculation. BellSouth also contends that forbearance from enforcing the growth caps and new markets rule will indirectly lead to increased payments from CLECs to ISPs, enabling the ISPs to make dial-up service more attractive by lowering their prices to subscribers. But, as the FCC responds, the record in the forbearance proceeding suggested that (inter alia) the increasing bandwidth requirements of popular website content will continue to erode dial-up usage notwithstanding a substantial price differential between dial-up and broadband service. *See* Bernstein Research Call, DSL Economics I at 2 (Oct. 15, 2003) (J.A. 113). Moreover, although the FCC has forborne from enforcing the growth caps and new markets rule, the rate caps remain in effect to cabin the

intercarrier compensation that makes such subsidization possible.

Finally, BellSouth attacks the FCC for failing to provide a reasoned explanation for its forbearance decision. BellSouth insists that the regime adopted in the *ISP Remand Order* "was designed not merely to *reduce* the amount paid to competitors for ISP-bound calls[,] . . . but also to *induce* competitors to move away from ISP-only business models." BellSouth Br. 22-23. And it contends that the *Forbearance Order* failed to explain why this objective, which the FCC had regarded as important to the maintenance of viable local telephone competition,[6] was no longer applicable. See *id.* at 23-24.

We disagree. As noted above, the purpose of the growth caps and new markets rule was not to eliminate all market distortions attendant to a reciprocal compensation regime, but rather "to ensure that *growth* in dial-up Internet access" and "*expansion* of the old compensation regime" would not undermine the FCC's efforts during the transition period. *ISP Remand Order*, 16 FCC Rcd at 9191, ¶ 86 (emphasis added); *id.* at 9189, ¶ 81 (emphasis added). Once the Commission determined that "[m]arket developments since 2001" had assuaged its concerns over such growth and expansion, it was reasonable for it to conclude that "the policies favoring a unified compensation regime outweigh any remaining concerns about the growth of dial-up Internet traffic." *Forbearance Order*, 19 FCC Rcd at 20186, ¶ 20. It is not for this court to second-guess the conclusion reached by the agency that Congress has entrusted with balancing

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[6] Section 160(b) provides that, "[i]n making the determination under subsection (a)(3)" that forbearance is consistent with the public interest, "the Commission shall consider whether forbearance . . . will promote competitive market conditions." 47 U.S.C. § 160(b).

those policies. *See Global Crossing Telecomms., Inc. v. FCC*, 259 F.3d 740, 746 (D.C. Cir. 2001); *Melcher v. FCC*, 134 F.3d 1143, 1152 (D.C. Cir. 1998).

IV

For the foregoing reasons, both the petition for review filed by Core and the petition for review filed by BellSouth are

denied.[7]

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[7] Prior to filing its petition for review, Core filed a document—styled as a "complaint for declaratory relief"—claiming that Core's petition for forbearance was granted by operation of law once the statutory deadline passed. Core's effort to invoke this court's equitable jurisdiction by arguing that its complaint fits within the rule of *Telecommunications Research & Action Center v. FCC*, 750 F.2d 70 (D.C. Cir. 1984), is misplaced. We are fully capable of reviewing any future Commission decision to enforce any provision of the *ISP Remand Order* or *Forbearance Order* against Core, and there is no need "to issue [a] writ[ ] of mandamus . . . to protect [our] prospective jurisdiction." *Id.* at 76. We therefore dismiss Core's complaint.

APPENDIX E
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 04-1179

IN RE CORE COMMUNICATIONS, INC.,
Petitioner,

FILED ON: MAY 24, 2005

ORDER

Before: Edwards, Randolph, and Garland, Circuit Judges.

Upon consideration of the petition for writ of mandamus, the response thereto, and the reply; the Federal Rule of Appellate Procedure 28(j) letters; the status report, and the supplement thereto; and the supplemental petition for writ of mandamus, it is

ORDERED that the petition for writ of mandamus be denied without prejudice to refiling in the event of significant additional delay. Petitioner has not shown the agency's delay is so egregious or unreasonable as to warrant the extraordinary remedy of mandamus. *See Telecommunications Research and Action Center v. FCC*, 750 F.2d 70, 80 (D.C. Cir. 1984).

Pursuant to D.C. Circuit Rule 36, this disposition will not be published.

Per Curiam

APPENDIX F
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 04-1179

IN RE: CORE COMMUNICATIONS, INC.,
Petitioner,

FILED ON: NOVEMBER 22, 2004

ORDER

Before: Sentelle, Henderson, and Tatel, Circuit Judges.

Upon consideration of the petition for writ of mandamus, the response thereto, and the reply; and the notices of supplemental authority pursuant to Fed. R. App. P. 28(j) and the responses thereto, it is

ORDERED that consideration of the petition for writ of mandamus be deferred pending further order of the court. The agency is directed to advise the court within 90 days from the date of this order, and every 90 days thereafter, of its progression in responding to the remand in *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

Per Curiam

APPENDIX G
BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FCC 04-241

WC DOCKET NO. 03-171

PETITION OF CORE COMMUNICATIONS, INC. FOR FORBEARANCE UNDER 47 U.S.C. § 160(c) FROM APPLICATION OF THE *ISP REMAND ORDER*

ORDER

ADOPTED: OCTOBER 8, 2004
RELEASED: OCTOBER 18, 2004

By the Commission: Commissioner Adelstein approving in part, dissenting in part, and issuing a statement.

I. INTRODUCTION

1. In this order, we address a petition filed by Core Communications, Inc. (Core)[1] requesting that the Com-

[1] *See Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, Petition of Core Communications, Inc. (filed July 14, 2003) (Core Forbearance Petition). On June 22, 2004, the Commission extended by 90 days, to October 11, 2004, the date by which the petition requesting forbearance shall be deemed granted in the absence of a Commission decision. *See Petition of Core Com-*

mission forbear from enforcing the provisions of the *ISP Remand Order*.[2] For the reasons set forth below, we deny the petition with respect to rate caps and the mirroring rule, and grant forbearance with respect to the growth caps and new markets rule.[3]

II. BACKGROUND

a. Intercarrier Compensation NPRM

2. On April 27, 2001, the Commission released a Notice of Proposed Rulemaking beginning a fundamental re-examination of all currently regulated forms of intercarrier compensation.[4] The Commission recognized the need to re-evaluate the existing intercarrier compensation regimes in light of increasing competition and new technologies, such as Internet and Internet-based services.[5] The Commission was particularly interested in identifying a unified approach to intercarrier compensation that would apply to all types of traffic and to interconnection arrangements between all types of carriers.[6]

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munications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order, WC Docket No. 03-171, Order, DA 04-1764, at 2 (rel. June 23, 2004).

[2] *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) *(ISP Remand Order), remanded, WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003). Although the court rejected the legal authority upon which the Commission based its rules, the court did not vacate the *ISP Remand Order*. Accordingly, the interim rules adopted in the *ISP Remand Order* remain in effect.

[3] *See infra* paras. 6-9.

[4] *See In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[5] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9611-12, para. 2.

[6] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9611-12, para. 2.

It identified a number of problems with the current intercarrier compensation regimes which potentially could be solved by adopting a bill-and-keep regime or some other unified approach to intercarrier compensation.[7]

3. In response to the *Intercarrier Compensation NPRM*, the Commission received extensive comment from individual carriers and economists, industry groups and associations, consumer advocates, and state regulatory commissions, among others.[8] In addition, the Commission received numerous *ex parte* filings and detailed presentations from interested parties. In parallel with the Commission's consideration of these issues, industry-wide negotiations have taken place over the last year that have resulted in four separate proposals for comprehensive reform of the intercarrier compensation regime.[9]

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[7] *Id.* at 9612, para. 2.

[8] The Commission received more than 750 submissions, including more than 250 formal comments and reply comments.

[9] For example, the Intercarrier Compensation Forum, a coalition of nine local and long-distance phone companies including AT&T, MCI, Sprint, SBC, Level 3, Global Crossing, GCI, Iowa Telecom, and Valor, recently proposed a multiyear intercarrier compensation reform plan and universal service plan. *See* Letter from Gary Epstein, Counsel for the Intercarrier Compensation Forum, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Aug. 16, 2004). *See also* Letter from Michael W. Young, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed May 14, 2004) (proposing a single cost-based compensation rate based on the total element long-run incremental cost methodology); Letter from Ken Pfister, Great Plains Communications, to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-92 and 04-28 (filed June 9, 2004) (proposing a unified rate plan based on embedded costs); and Letter from Glenn H. Brown, Expanded Portland Group, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed May 12, 2004) (proposing a unified capacity-based compensation plan).

The Commission plans to move forward expeditiously in consideration of these new proposals.

b. ISP Remand Order

4. Concurrent with the *Intercarrier Compensation NPRM*, the Commission released the *ISP Remand Order*. In that order, it concluded that traffic bound for Internet Service Providers (ISPs) is not subject to the reciprocal compensation requirements of section 251(b)(5).[10] The Commission concluded that ISP-bound traffic is "information access" and, therefore, is "carved out" of the scope of section 251(b)(5) by section 251(g), which preserves certain pre-Act equal access and interconnection arrangements, including compensation obligations.[11] It also affirmed its prior finding that ISP-bound traffic is jurisdictionally interstate and thus subject to the Commission's section 201 jurisdiction.[12]

5. In the *ISP Remand Order*, the Commission discussed at length the market distortions and regulatory arbitrage opportunities created by the application of per-minute reciprocal compensation rates to ISP-bound traffic.[13] The Commission found that the availability of reciprocal compensation for this type of traffic undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers, thereby distorting the price signals sent to their ISP customers.[14] It concluded that a bill-and-keep regime might eliminate in-

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[10] *ISP Remand Order*, 16 FCC Rcd at 9171-72, para. 44.

[11] *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52; *see also* 47 U.S.C. § 251(g).

[12] *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52.

[13] *ISP Remand Order*, 16 FCC Rcd at 9181-86, paras. 67-76.

[14] *ISP Remand Order*, 16 FCC Rcd at 9183, para. 71.

centives for arbitrage and force carriers to look to their own customers for cost recovery.[15] To avoid a flash cut to bill-and-keep, however, the Commission adopted an interim compensation regime pending completion of the *Intercarrier Compensation NPRM* proceeding.[16]

6. *Rate Caps.* The interim regime adopted by the Commission consisted of a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use.[17] These rate caps reflected the downward trend in intercarrier compensation rates contained in recently negotiated interconnection agreements.[18] The rate caps limited only what carriers could recover from other carriers; carriers remained free to recover any additional costs from their ISP customers. Because the interim rates were *caps* on intercarrier compensation, the Commission determined that, to the extent the states had already set rates below the caps or imposed bill-and-keep for ISP-bound traffic (or otherwise had not required payment of compensation for this traffic), the lower rates would continue to apply.

7. *Growth Caps.* In addition to reducing the intercarrier compensation rates, the Commission also imposed a cap on total ISP-bound minutes for which a LEC may receive this compensation equal to the total ISP-bound minutes for which the LEC was previously entitled to

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[15] ISP Remand Order, 16 FCC Rcd at 9184-85, paras. 74-75.

[16] This interim regime altered only intercarrier compensation rates; it did not alter carriers' other obligations under the Commission's Part 51 rules or existing interconnection agreements. *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78, n.149.

[17] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

[18] *ISP Remand Order*, 16 FCC Rcd at 91990-91, para. 85.

compensation, plus a 10 percent growth factor.[19] These "growth caps" were based on projections of the growth of dial-up Internet access for the first two years of the transition and were considered necessary to ensure that such growth would not undermine the Commission's goal of addressing the market distortions attributable to the prevailing intercarrier compensation mechanism for ISP-bound traffic.[20]

8. *Mirroring Rule.* The Commission also determined that the rate caps for ISP-bound traffic (or such lower rates as had been imposed by state commissions for the exchange of ISP-bound traffic) should apply only if an incumbent LEC offered to exchange all traffic subject to section 251(b)(5) at the same rates.[21] If a LEC did not offer to exchange section 251(b)(5) traffic at the rates set forth in the *ISP Remand Order*, it was required to exchange ISP-bound traffic at the state-approved or state-arbitrated reciprocal compensation rates. The Commission adopted this "mirroring" rule to ensure that incumbent LECs paid the same rates for ISP-bound traffic that they received for section 251(b)(5) traffic.

9. *New Markets Rule.* Finally, the Commission concluded that different interim intercarrier compensation rules should apply if two carriers were not exchanging traffic pursuant to an interconnection agreement prior to the adoption of the *ISP Remand Order*.[22] In this situation, if an incumbent LEC has opted into the federal rate caps for ISP-bound traffic, the two carriers must exchange this traffic on a bill-and-keep basis during the

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[19] *ISP Remand Order*, 16 FCC Rcd at 9191, para. 86.

[20] *ISP Remand Order*, 16 FCC Rcd at 9191, para. 86.

[21] *ISP Remand Order*, 16 FCC Rcd at 9193-94, para. 89.

[22] *ISP Remand Order*, 16 FCC Rcd at 9188-89, para. 81.

interim period (the "new markets" rule).[23] This rule applies, for example, when a new carrier enters a market or an existing carrier expands into a market it previously had not served. The Commission implemented this rule in order to confine the opportunities for regulatory arbitrage to the maximum extent while seeking an appropriate long-term resolution for the problems associated with the existing intercarrier compensation regime.[24]

10. On May 3, 2002, the United States Court of Appeals for the District of Columbia Circuit found that the Commission had not provided an adequate legal basis for the rules it adopted in the *ISP Remand Order*.[25] Although the court rejected the legal rationale for the interim compensation rules, the court remanded, but did not vacate, the *ISP Remand Order* to the Commission, observing that there may be other legal bases for adopting the rules.[26] Accordingly, the interim rules adopted in the *ISP Remand Order* remain in effect while the court remand is under review.

c. Core Forbearance Petition

11. Core filed a petition on July 14, 2003, requesting that the Commission forbear from enforcing the provisions of the *ISP Remand Order* with respect to the exchange of ISP-bound traffic between telecommunications carriers.[27] More specifically, Core asks the Commission

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[23] *ISP Remand Order*, 16 FCC Rcd at 9188-89, para. 81.

[24] *ISP Remand Order*, 16 FCC Rcd at 9188-89, para. 81.

[25] *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002). Specifically, the court stated that section 251(g) of the Act does not provide a basis for the Commission's decision to create an exception to the reciprocal compensation requirements of the Act for calls made to ISPs located within the caller's local calling area. *Id.* at 434.

[26] *WorldCom v. FCC*, 288 F.3d at 434.

[27] Core Forbearance Petition at 1.

to forbear from applying the rate caps, growth caps, new markets rule, and mirroring rule of the *ISP Remand Order*.[28]

12. Core contends that the rules promulgated under the *ISP Remand Order* are unsustainable for several reasons. It claims that the D.C. Circuit remand decision calls into question the legality of the rules promulgated under the *ISP Remand Order*.[29] Core also claims that the rules discriminate against new entrants.[30] Core further contends that the *ISP Remand Order* has discouraged investment by telecommunications companies.[31] Finally, Core argues that the Commission should forbear from applying the *ISP Remand Order*, because the rules are not necessary to prevent harm to consumers or to protect carriers from anticompetitive harm, and because forbearance is in the public interest.[32]

13. A number of incumbent LECs oppose the petition.[33] In general, they argue that Core has not met the statutory criteria for forbearance, and they accuse Core of wanting to preserve a business plan dependent on regulatory arbitrage.[34] BellSouth states that Core offers no substantiated evidence to meet the statutory criteria for forbearance.[35] Qwest argues that consumers and the

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[28] *Id.* at 6-7; Core Reply at 5.

[29] Core Forbearance Petition at 3-4.

[30] Core Forbearance Petition at 4-6.

[31] Core Forbearance Petition at 6-9.

[32] Core Forbearance Petition at 9-11.

[33] A list of parties filing comments or oppositions in this docket is attached as Appendix A.

[34] *See* BellSouth Opposition at 3-4, 9-13; Qwest Opposition at 11-14; SBC Opposition at 3-5; Verizon Opposition at 2-4.

[35] Bellsouth Opposition at 4.

rest of the telecommunications industry should not be subject to harm simply because competitive LECs such as Core based their business plans on regulatory arbitrage.[36] SBC contends that Core's forbearance request would undermine the goals of a more rational cost recovery mechanism and reducing the market-distorting effects of reciprocal compensation for ISP-bound traffic.[37] Verizon argues that Core has no interest in being a "real local service provider," and that Core's assertions without any attempted proof are irrelevant to a forbearance analysis.[38]

14. A variety of parties filed comments supporting the petition. The West Virginia PSC Consumer Advocate Division argues that the statutory criteria for forbearance have been met, and it complains that the intercarrier compensation mechanism in place is based on an invalid assertion of jurisdiction.[39] MCI and TelNet also argue that the current rules have no basis in law, and that a bill and keep compensation regime is discriminatory and unfair with respect to ISP-bound traffic.[40] Xspedius contends that the Bell Operating Companies (BOCs) have not lived up to their obligations under the *ISP Remand Order*.[41]

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[36] Qwest Opposition at 12.

[37] SBC Opposition at 3.

[38] Verizon Opposition at 2-4.

[39] West Virginia PSC Consumer Advocate Division Comments at 3-20.

[40] MCI Comments at 2-3; TelNet Comments at 1-2.

[41] Xspedius Comments at 1-3. Xspedius contends that the BOCs have refused to pay the proper amount of money due for intercarrier compensation, forcing Xspedius to engage in protracted negotiations. *Id.*

III. DISCUSSION

15. For the Commission to grant the forbearance requested by Core, we must determine that the three conditions set forth in section 10 of the Act are satisfied. In particular, section 10(a) provides that:

> The Commission shall forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets, if the Commission determines that—
>
> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable, and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.[42]

We note that Core's petition would be denied if any one of these prongs is not met. For the reasons explained

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[42] 47 U.S.C. § 160(a). With regard to the public interest determination required by section 10(a)(3), section 10(b) requires the Commission to "consider whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services." 47 U.S.C. § 160(b). Furthermore, "[i]f the Commission determines that such forbearance will promote competition among providers of telecommunications services, that determination may be the basis for a Commission finding that forbearance is in the public interest." *Id.*

below, we find that none of the three prongs is satisfied with respect to the rate caps and mirroring rule, but that all three prongs are met with respect to the growth caps and new markets rule.

A. Public Interest

16. Core has provided only a cursory analysis of how each of the three criteria is satisfied. Core's primary argument is that the rules discriminate against competitive LECs in favor of BOCs. Core contends that the *ISP Remand Order* "has no basis in law and discriminates against and among competitive LECs in favor of the BOCs in a manner that is wholly inconsistent with the policy goals of the Act."[43] Core also asserts, without support, that these rules "have deterred investment in the telecommunications business, and have thereby substantially harmed the competitive telecommunications industry and the broader national economy."[44] Core complains that the mirroring rule is unfair, asserting that it allows BOCs to determine unilaterally the intercarrier compensation rates applicable to ISP-bound traffic.[45] We find that all of these arguments are properly considered under the third prong of the forbearance analysis, which requires the Commission to consider whether forbearance is consistent with the public interest, and whether forbearance would "promote competitive market conditions."[46] For the reasons described below, we find that

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[43] Core Forbearance Petition at 2-3. According to Core, "the anti-competitive impact of the *ISP Remand Order* has dealt a crushing blow to CLECs, the telecommunications industry, and the broader national economy." *Id.* at 3.

[44] Core Forbearance Petition at 6.

[45] Core Reply at 5. *See also* West Virginia PSC Consumer Advocate Division Comments at 6, 11-14.

[46] 47 U.S.C. §§ 160(a)(3), 160(b).

Core's arguments do not satisfy the requirements of section 10(a)(3). As explained below, we do find, on other grounds, that section 10(a)(3) has been met with respect to the growth caps and the new markets rules.

17. As an initial matter, we reject Core's argument that the *WorldCom* decision somehow compels us to grant the requested forbearance.[47] The court remanded but did not vacate the rules adopted in the *ISP Remand Order*.[48] The court specifically stated that there was a "non-trivial likelihood" that the Commission would be able to justify the regime it adopted.[49] Given this statement by the court, its decision to remand our order is not in itself a sufficient basis for forbearance.

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[47] *See* Core Forbearance Petition at 3-4. *See also* MCI Comments at 2; TelNet Comments at 2.

[48] *WorldCom, Inc. v. FCC*, 288 F.3d at 434.

[49] *WorldCom, Inc. v. FCC*, 288 F.3d at 434. We choose not to address the pending remand issues in this order. As explained above, and as we have explained to the D.C. Circuit in response to Core's pending mandamus petition, the Commission is considering comprehensive reform of intercarrier compensation mechanisms for all traffic, including ISP-bound traffic. *See In re Core Communications, Inc.*, Response of Federal Communications Commission to Petition for Writ of Mandamus, File No. 04-1179, United States Court of Appeals for the District of Columbia Circuit (Aug. 19, 2004) at 8-9. We have been presented with four separate proposals from different industry groups. *See* note 8 above. These proposals represent the product of unprecedented industry-wide negotiations regarding this extremely complex subject matter. We hope to move forward expeditiously in our consideration of these proposals. We find that the benefit of considering these important issues in a comprehensive manner outweighs the consequences, if any, of a delay in responding to the *WorldCom* remand. For similar reasons, we choose not to address pending petitions for reconsideration, clarification, or waiver of the *ISP Remand Order* at this time.

18. We also reject Core's broad, unsupported allegations that these rules "have brought about anticompetitive harm to CLECs, deterred investment in telecommunications businesses, limited the service options available to telecommunications consumers, and severely damaged the state of the telecommunications industry and the broader economy."[50] Core provides no evidence to support these claims. Nor does it challenge the continuing validity of the public interest rationale provided by the Commission when it adopted these rules.[51] The Commission implemented the rate caps because the application by state commissions of per-minute reciprocal compensation rates to ISP-bound traffic "created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets."[52] These caps, which apply to all carriers, were designed to send more accurate price signals and substantially reduce market distortions.[53] Core does not challenge the Commission's conclusion that rate caps help avoid arbitrage and market distortions that otherwise would result from the availability of reciprocal compensation for ISP-bound traffic.

19. Nor does Core address the Commission's concern that, without the mirroring rule, incumbent LECs would too easily be able to take advantage of the discrepancy between reduced rates for ISP-bound traffic and higher rates for section 251(b)(5) voice traffic. The mirroring

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[50] Core Forbearance Petition at 11.

[51] *See* Core Forbearance Petition at 11; *see also ISP Remand Order*, 16 FCC Rcd at 9154-56, 9162, 9181-84, 9186-87, paras. 5, 7, 21, 67-71, 73, and 77.

[52] *ISP Remand Order*, 16 FCC Rcd at 9153, para. 2.

[53] *ISP Remand Order*, 16 FCC Rcd at 9186, para. 77.

rule was adopted to preclude incumbent LECs from paying reduced intercarrier compensation rates for ISP-bound traffic, which they send to competitive LECs, while collecting higher state reciprocal compensation rates for traffic that they receive. In addition, the mirroring rule promotes our goal of a more unified intercarrier compensation regime by requiring LECs to offer similar rates for like traffic. We find that the rate caps and mirroring rule remain necessary to prevent regulatory arbitrage and promote efficient investment in telecommunications services and facilities.

20. *Growth Caps.* We find that the growth caps are no longer in the public interest. Market developments since 2001 have eased the concerns about growth of dial-up ISP traffic that led the Commission to adopt these rules. The Commission imposed an overall cap on ISP-bound minutes for which compensation is due in order to ensure that growth in dial-up Internet access would not undermine the Commission's efforts to limit intercarrier compensation for this traffic, and to address intercarrier compensation in a comprehensive and unified manner.[54] At the time of the *ISP Remand Order*, the Commission sought to prevent continued expansion of the arbitrage opportunity presented by ISP-bound traffic.[55] Recent industry statistics indicate, however, that this expansion is not likely to occur given declining usage of dial-up ISP services. For example, one recent report suggests that the number of end users using conventional dial-up to connect to ISPs is declining as the number of end users using broadband services to access ISPs grows.[56] We do

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[54] *ISP Remand Order* 16 FCC Rcd at 9101, para. 86.

[55] *ISP Remand Order*, 16 FCC Rcd 9188-89, para. 81.

[56] *See* Letter from Charles D. Breckinridge, Counsel for Level 3, to Marlene H. Dortch, Secretary, Federal Communications Commis-

not anticipate, therefore, that the availability of compensation to carriers that serve ISPs will have any material impact on the migration of consumers from dial-up services to broadband services. Thus, we now conclude that the policies favoring a unified compensation regime outweigh any remaining concerns about the growth of dial-up Internet traffic.[67]

21. *New Markets Rule.* We also find that the new markets rule is no longer in the public interest. This rule creates different rates for similar or identical functions. As explained above, although the Commission implemented this rule in order to confine the opportunities for regulatory arbitrage, we find that these arbitrage concerns have decreased, and that these concerns are now outweighed by the public interest in creating a uniform compensation regime. Accordingly, we find that forbearance from this rule is consistent with the public interest.

B. Discrimination

22. Section 10(a)(1) requires us to determine whether application of rate caps, growth caps, the mirroring rule, and the new markets rule are still "necessary to ensure that the charges, practices, classifications or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discrimi-

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sion, CC Docket Nos. 96-98, 99-68, 03-266, and 04-36, Attach at Ex. 1 (filed June 25, 2004 (attaching a report by Bernstein Research entitled "DSL Economics I: Continued Broadband Adoption to Drive 22% DSL Revenue Growth Through 2008"); *see also Federal Communications Commission Releases Data on High Speed Services For Internet Access*, News, at Table 1 (rel. June 8, 2004) (reporting only 2.7 million high-speed Internet access lines in December 1999 and 28 million high-speed Internet access lines in December 2003).

[67] *See infra* paras. 23-24.

natory."[58] Core argues that the rules are "discriminatory" and unfairly distinguish among CLECs.[59] More specifically, Core argues that "the reduced rates for reciprocal compensation, new market bar, and growth cap" require "only certain CLECs to recoup their terminating switch costs for ISP-bound traffic from their end users," thereby putting "those carriers at a competitive disadvantage as compared to the BOCs, and to other competitive carriers established within a specific local market prior to the Commission's implementation of the *ISP Remand Order*."[60] We find that Core has not met the statutory test with respect to the rate caps or mirroring rule. We do find, however, that the growth caps and new markets rule are no longer necessary to ensure that charges and practices are just and reasonable.

23. *Rate Caps and Mirroring Rule.* Core has not demonstrated that enforcement of the rate caps or mirroring rule is no longer necessary to ensure that charges and practices are "just and reasonable," or to prevent rates that are "unjustly or unreasonably discriminatory." We find that the potential for discrimination under the rate caps is limited because the caps apply to ISP-bound traffic only if an incumbent LEC offers to exchange all section 251(b)(5) traffic at the same rate.[61] The mirroring rule was adopted based on our finding that the record lacked evidence of any material differences between the costs of delivering ISP-bound traffic and local voice traf-

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[58] 47 U.S.C. § 160(a)(1).

[59] Core Forbearance Petition at 2-3. Core contends that the *ISP Remand Order* "has no basis in law and discriminates against and among competitive LECs in favor of the BOCs in a manner that is wholly inconsistent with the policy goals of the Act." *Id.*

[60] Core Forbearance Petition at 9-10.

[61] *ISP Remand Order*, 16 FCC Rcd at 9193-94, para. 89.

fic that would justify any difference in treatment between the two with respect to intercarrier compensation.[62] Because the record still lacks any such evidence, we affirm our prior conclusion that the mirroring rule is necessary to prevent disparate treatment of the two types of traffic. Accordingly, Core has not demonstrated that the rules result in impermissible discrimination against or between CLECs, or that the Commission's justifications for the interim rules are no longer valid.

24. *Growth Caps and New Markets Rule.* Both the growth caps and new markets rule require carriers to exchange ISP-bound traffic on a bill-and-keep basis under certain circumstances. Under the new markets rule, carriers must exchange ISP-bound traffic on a bill-and-keep basis if those carriers were not exchanging traffic pursuant to interconnection agreements prior to adoption of the *ISP Remand Order*.[63] Under the growth caps, carriers may not receive compensation for ISP-bound minutes exceeding a particular growth factor.[64] Thus, the compensation rate for ISP-bound traffic in these circumstances is different than the rate that applies to ISP-bound traffic under the rate caps or to section 251(b)(5) traffic under the reciprocal compensation regime. These rules were adopted in order to prevent the expansion of the arbitrage opportunity associated with ISP-bound traffic. Given the market developments since that time,[65] however, we find that these rules are no longer necessary to ensure that charges and practices are just and reasonable, and not unjustly or unreasonably discrimina-

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[62] *ISP Remand Order*, 16 FCC Rcd at 9196, para. 93.

[63] *ISP Remand Order*, 16 FCC Rcd at 9188-89, para. 81.

[64] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

[65] *See supra* para. 20.

tory. As the Commission observed in the *ISP Remand Order*, carriers likely incur the same costs when delivering a call to a local end user and a data call to an ISP.[66] In that order, the Commission declined to establish separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.[67] It concluded that the record failed to demonstrate different costs in delivering traffic that would justify disparate treatment of ISP-bound traffic and local voice traffic under section 251(b)(5). These conclusions suggest that similar rates should apply to both local voice traffic and ISP-bound traffic, absent compelling policy reasons to the contrary.[68] Accordingly, because we conclude that the policy rationale for those rules no longer outweighs policies favoring a unified compensation regime, we conclude that forbearance is warranted.

C. Protection of Consumers

25. Section 10(a)(2) requires us to determine whether application of these rules is still "necessary for the protection of consumers."[69] Core makes no specific arguments to demonstrate that forbearance from the rules at issue would satisfy this standard. Instead, Core makes a general claim, without providing any support, that the rate cap, growth cap, and new markets rule have created "artificially high rates and reduced competitive choice," and have "forced CLECs from the market and deterred investment in telecommunications business, thereby lim-

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[66] *ISP Remand Order*, 16 FCC Rcd at 9194, para. 90.

[67] *ISP Remand Order*, 16 FCC Rcd at 9194, para. 90.

[68] *See ISP Remand Order*, 16 FCC Rcd at 9197, para. 93 (concluding that there was no reason to distinguish between voice and ISP-bound traffic with respect to intercarrier compensation).

[69] 47 U.S.C. § 160(a)(2).

iting the service options available to telecommunications consumers."[70] Core's speculation regarding the connection between the *ISP Remand Order*, reduced investment in telecommunications facilities, and reduced choices for consumers does not satisfy the second prong of the statutory criteria for forbearance. Indeed, the rate caps and mirroring rule were implemented to prevent the subsidization of dial-up Internet access customers at the expense of consumers of basic telephone service, and to avoid arbitrage and discrimination between services. Core has provided no evidence regarding reduced investment or reduced competitive choices for consumers, nor has it provided any evidence demonstrating that the *ISP Remand Order* is the cause of any such developments. Accordingly, we find that Core has not shown that rate caps or the mirroring rule are "not necessary for the protection of consumers."

26. *Growth Caps and New Markets Rule.* We do find, on other grounds, that application of the growth caps and new markets rule is not "necessary for the protection of consumers."[71] These rules are directly related to intercarrier compensation, and were not implemented specifically for the protection of consumers. As explained above, growth caps limit the total ISP-bound minutes for which a LEC may receive compensation.[72] The new markets rule conditions the availability of com-

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[70] Core Forbearance Petition at 10-11. *See also* Core Reply at 8 (discussing the growth cap and new markets rule). Core makes a related argument that these rules "have deterred investment in the telecommunications business, and have thereby substantially harmed the competitive telecommunications industry and the broader national economy." Core Forbearance Petition at 6.

[71] 47 U.S.C. § 160(a)(2).

[72] *ISP Remand Order*, 16 FCC Rcd at 9191, para. 86.

pensation on whether two carriers were exchanging traffic pursuant to an interconnection agreement prior to the adoption of the *ISP Remand Order*.[73] Accordingly, we find that neither the growth caps nor the new markets rule is necessary for the protection of consumers, and that forbearance is therefore warranted under this prong.

D. Applicability

27. Our rationale for forbearance with respect to the growth caps and new markets rules applies with equal force to other telecommunications carriers. Accordingly, on our own motion, we extend the grant of forbearance with respect to those rules to all telecommunications carriers.

E. Effective Date

28. Consistent with section 10 of the Act and our rules, the Commission's forbearance decision shall be effective on Friday, October 8, 2004.[74] The time for appeal shall run from the release date of this order.[75]

IV. ORDERING CLAUSES

29. Accordingly, IT IS ORDERED that the petition for forbearance of Core Communications IS DENIED in part and GRANTED in part, as set forth herein.

30. IT IS FURTHER ORDERED, pursuant to section 10 of the Communications Act of 1934, 47 U.S.C. 160, and section 1.103(a), that the Commission's forbearance decision SHALL BE EFFECTIVE on October 8, 2004.

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[73] *ISP Remand Order*, 16 FCC Rcd at 9188-89, para. 81.

[74] *See* 47 U.S.C. § 160(c) (deeming the petition granted as of the forbearance deadline if the Commission does not deny the petition within the time period specified in the statute), and 47 C.F.R. § 1.103(a).

[75] *See* 47 C.F.R. §§ 1.4 and 1.13.

Pursuant to sections 1.4 and 1.13 of the Commission's rules, 47 C.F.R. 1.4 and 1.13, the time for appeal shall run from the release date of this Order.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch

Secretary

STATEMENT OF COMMISSIONER JONATHAN S. ADELSTEIN

Re: Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order, WC Docket No. 03-171, Order

I approve in part and dissent in part from this Order addressing our compensation rules for traffic destined to Internet Service Providers (ISPs). This Order largely retains our current rules for compensation for ISP-bound traffic based on a reasonable application of the statutory forbearance criteria. The Commission's existing rules were designed to limit opportunities for what the Commission had previously characterized as regulatory arbitrage.

I dissent in part from the Order, however, to the extent that it grants forbearance from two prongs of the Commission's rules concerning growth caps and new markets. While I appreciate competitive carriers' concern about the application of these rules to carriers late to serve the ISP market, the record before us does not persuasively suggest that the bases for the Commission's prior concerns about opportunities for regulatory arbitrage and disincentives to serve non-ISP end-user customers have dissipated. Though commenters argue that the number of dial-up subscribers has declined since the Commission last addressed this issue, the record before us suggests that dial-up minutes for ISP-bound traffic have held steady or are increasing in many areas of the country. More broadly, regulatory treatment of this traffic raises numerous complex issues for our policies regarding local competition, access to the Internet, and broadband deployment. These issues may be particularly pronounced for many rural areas, where broadband penetration rates may be lower than other areas of the

country. Given the present record and these larger concerns, I would not have granted relief at this time.

APPENDIX H
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

NOS. 01-1218, 01-1229, 01-1243, 01-1255 THROUGH 01-1257, 01-1267, 01-1274, 01-1310, 01-1311, 01-1313, 01-1319, 01-1321

WORLDCOM, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

SPRINT CORPORATION, ET AL.,
Intervenors,

ARGUED FEB. 12, 2002
DECIDED MAY 3, 2002

On Petitions for Review of an Order of the Federal Communications Commission

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Before: SENTELLE and TATEL, Circuit Judges, and WILLIAMS, Senior Circuit Judge.

Opinion for the Court filed by Senior Circuit Judge WILLIAMS.

STEPHEN F. WILLIAMS, Senior Circuit Judge:

Section 251(b)(5) of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-714 (the "1996 Act" or the "Act"), directs all local exchange carriers ("LECs") to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). In the order before us the Federal Communications Commission held that under § 251(g) of the Act it was authorized to "carve out" from § 251(b)(5) calls made to internet service providers ("ISPs") located within the caller's local calling area. It relied entirely on § 251(g). Because that section is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act, we find the Commission's reliance on § 251(g) precluded. Thus we remand the case. Because there may well be other legal bases for adopting the rules chosen by the Commission for compensation between the originating and the terminating LECs in calls to ISPs, we neither vacate the order nor address petitioners' attacks on various interim provisions devised by the Commission.

* * *

Due in part to the 1996 Act, local telephone service areas are now typically (perhaps universally) served by more than one LEC. The reciprocal compensation requirement of § 251(b)(5), quoted above, is aimed at assuring compensation for the LEC that completes a call originating within the same area. Although its literal language purports to extend reciprocal compensation to *all* "telecommunications," the Commission has construed it as limited to "local" traffic only. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499,

16012-13, ¶¶ 1033-34, 16015-16, ¶ 1040, 1996 WL 452885 (1996) ("*Local Competition Order*"); 47 C.F.R. § 51.701(a). For long distance calls, by contrast, the long-distance carrier collects from the user and pays both LECs—the one originating and the one terminating the call. *Local Competition Order*, 11 FCC Rcd at 16013, ¶ 1034.

In an earlier order, the Commission excluded ISP calls from the reach of § 251(b)(5) on the theory that they were indeed not "local." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689, 1999 WL 98037 (1999) ("*Initial Order*"). It reached this conclusion by applying its "end-to-end" analysis, traditionally employed in determining whether a call was jurisdictionally interstate or not, stressing that ISP-bound traffic ultimately reaches websites that are typically located out-of state. See *id.* at 3689-90, ¶ 1, 3695-98, ¶¶ 10-12, 3703, ¶ 23 (1999). On review, we held that the order had failed to adequately explain why the traditional "end-to-end" jurisdictional analysis was relevant to deciding whether ISP calls fitted the local call or the long-distance call model, and vacated and remanded the order. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 5, 8 (D.C. Cir. 2000).

On remand, the FCC again reached the conclusion that the compensation between two LECs involved in delivering internet-bound traffic to an ISP should not be governed by the reciprocal compensation provision of § 251(b)(5). *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9152-53, ¶ 1 (2001) ("*Remand Order*"). This decision rested, as we said, on § 251(g).

Having thus taken ISP calls out of § 251(b)(5)'s reciprocal compensation obligation, the FCC proceeded to establish what it believed was an appropriate cost recovery mechanism. *Remand Order*, 16 FCC Rcd at 9154, ¶ 4. The system adopted was "bill-and-keep," whereby each carrier recovers its costs from its own end-users. *Id.*

In reaching the bill-and-keep solution, the Commission pointed to a number of flaws in the prevailing intercarrier compensation mechanism for ISP calls, under which the originating LEC paid the LEC that served the ISP. Because ISPs typically generate large volumes of one-way traffic in their direction, the old system attracted LECs that entered the business simply to serve ISPs, making enough money from reciprocal compensation to pay their ISP customers for the privilege of completing the calls. The Commission saw this as leading, at least potentially, to ISPs' charging *their* customers below cost. *Remand Order*, 16 FCC Rcd at 9153, ¶ 2, 9154-55, ¶¶ 4-6, 9162, ¶¶ 19-21.

To smooth the transition to bill-and-keep (but without fully committing itself to it), the FCC adopted several interim cost-recovery rules that sought to limit arbitrage opportunities by lowering the amounts and capping the growth of ISP-related intercarrier payments. These tend to force ISP-serving LECs to recover an increasing portion of their costs from their own subscribers rather than from other LECs. *Remand Order*, 16 FCC Rcd at 9155-57, ¶¶ 7-8. The transitional rules take effect on the expiration of existing interconnection agreements. *Id.* at 9189, ¶ 82. Finally, the Commission specified that, having carved ISP-bound calls out of § 251(b)(5) under § 251(g), it was establishing the interim compensation regime under its general authority to regulate the rates and terms of interstate telecommunications services and

interconnections between carriers under § 201 of the Act; as a result, the state regulatory commissions would no longer have jurisdiction over ISP-bound traffic as part of their power to resolve LEC interconnection issues under § 252(c)(1) of the Act. *Id.*

Two sets of petitioners now challenge the Remand Order. One, headed by WorldCom (collectively "WorldCom"), consists of competitive LECs that deliver calls to ISPs, and thus stand to lose reciprocal compensation payments. These companies contend that the Commission erred in finding that § 251(g) authorized Commission exclusion of such calls from § 251(b)(5), and that, in any event, the interim compensation rules that the FCC adopted were not a product of reasoned decisionmaking and are contrary to the Act's terms. The other group, composed of several states and state regulatory commissions, complains that the order unlawfully preempts their authority to determine the compensation of ISP-serving LECs.

* * *

Section 251(g) reads as follows:

> (g) Continued enforcement of exchange access and interconnection requirements.
>
> On and after [the date of enactment of the Telecommunications Act of 1996,] each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, *information access*, and exchange services for such access *to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding [the*

> *date of enactment of the Telecommunications Act of 1996]* under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after [such date of enactment]. During the period beginning on [such date of enactment] and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

47 U.S.C. § 251(g) (emphasis added). Both sides assume that *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), is applicable, so that we must defer to any reasonable Commission interpretation not precluded by the language of the statute, read with the ordinary tools of statutory construction. We agree with petitioners that § 251(g) is not susceptible to the Commission's reading.

On its face, § 251(g) appears to provide simply for the "continued enforcement" of certain pre-Act regulatory "interconnection restrictions and obligations," including the ones contained in the consent decree that broke up the Bell System, until they are explicitly superceded by Commission action implementing the Act. As the Conference Report explained, "[b]ecause the [Act] completely eliminates the prospective effect of the AT&T Consent Decree, some provision is necessary to keep these requirements in place. . . . Accordingly, the conference agreement includes a new section 251(g)." H.R. Rep. 104-458, at 122-23 (1996), U.S. Code Cong. & Admin. News 1996, 10, 134.

On a prior occasion, the Commission also framed the scope of § 251(g) in similarly narrow terms:

> The term "information access" first appears [in the Act] in sections [sic] 251(g). That provision is a *transitional enforcement mechanism* that obligates the incumbent LECs to continue to abide by equal access and nondiscriminatory interconnection requirements of the [AT&T Consent Decree] when such carriers "provide exchange access, information access and exchange services for such access to interexchange carriers and information service providers. . . ." Because the provision incorporates into the Act, on a transitional basis, these [AT&T Consent Decree] requirements, the Act uses [AT&T Consent Decree] terminology in this section. *However, this provision is merely a continuation of the equal access and nondiscrimination provisions of the Consent Decree until superseded by subsequent regulations of the Commission.*

In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, 15 FCC Rcd 385, 407, ¶ 47, 1999 WL 1244007 (1999) (footnote omitted) (emphasis added).

Of course such explanatory language can't be assumed to be exclusive; legislative or agency explanations of a provision may naturally tend to focus on its most salient features. Thus, despite legislative history speaking only in terms of the Consent Decree, plainly the pre-existing "restrictions and obligations" covered by § 251(g) are *not* limited to Consent Decree obligations; the statute itself explicitly embraces preexisting obligations under a "regulation, order, or policy of the Commission." See also *Noland v. Shalala*, 12 F.3d 258, 262 (D.C. Cir. 1994) ("Although the legislative history . . . suggests an exclusive focus [of the statutory provision in question], the statutory language is broader and may permit [an alter-

native] construction."). But nothing in § 251(g) seems to invite the Commission's reading, under which (it seems) it could override virtually any provision of the 1996 Act so long as the rule it adopted were in some way, however remote, linked to LECs' pre-Act obligations.

We will assume without deciding that under § 251(g) the Commission might *modify* LECs' pre-Act "restrictions" or "obligations," pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption in *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), where it implicitly relied on § 251(g) (by quoting language from an Eighth Circuit case, *Competitive Telecom. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997)), in sustaining modifications of pre-Act regulations governing the access charges paid to LECs by interexchange carriers ("IXCs"). *Id.* at 324-25. But this assumption is not enough to justify the Commission's action here, as it seems uncontested—and the Commission declared in the Initial Order—that there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic. See *Initial Order*, 14 FCC Rcd at 3695, ¶ 9; see also *id.* at 3690, ¶ 1, 3707-3710, ¶¶ 28-36. The best the Commission can do on this score is to point to pre-existing LEC obligations to provide interstate access for ISPs. See, e.g., *Remand Order*, 16 FCC Rcd at 9164, ¶ 27; *In the Matter of MTS & WATS Market Structure*, 97 F.C.C.2d 682, 711-15, ¶¶ 77-83 (1983). Indeed, the Commission does not even point to any pre-Act, federally created obligation for LECs to interconnect to each other for ISP-bound calls. And even if this hurdle were overcome, there would remain the fact that § 251(g) speaks only of services provided "to interexchange carriers and information service providers"; LECs' services to other

LECs, even if en route to an ISP, are not "to" either an IXC or to an ISP.

Having found that § 251(g) does not provide a basis for the Commission's action, we make no further determinations. For example, as in *Bell Atlantic*, we do not decide whether handling calls to ISPs constitutes "telephone exchange service" or "exchange access" (as those terms are defined in the Act, 47 U.S.C. §§ 153(16), 153(47)) or neither, or whether those terms cover the universe to which such calls might belong. Nor do we decide the scope of the "telecommunications" covered by § 251(b)(5). Nor do we decide whether the Commission may adopt bill-and-keep for ISP-bound calls pursuant to § 251(b)(5); see § 252(d)(B)(i) (referring to bill-and-keep). Indeed these are only samples of the issues we do not decide, which are in fact all issues other than whether § 251(g) provided the authority claimed by the Commission for not applying § 251(b)(5).

Moreover, we do not decide petitioners' claims that the interim pricing limits imposed by the Commission are inadequately reasoned. Because we can't yet know the legal basis for the Commission's ultimate rules, or even what those rules may prove to be, we have no meaningful context in which to assess these explicitly transitional measures.

Finally, we do not vacate the order. Many of the petitioners themselves favor bill-and-keep, and there is plainly a non-trivial likelihood that the Commission has authority to elect such a system (perhaps under §§ 251(b)(5) and 252(d)(B)(i)). See, e.g., *Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm.*, 988 F.2d 146, 150-51 (D.C. Cir. 1993) ("The decision whether to vacate depends on 'the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and

the disruptive consequences of an interim change that may itself be changed.'"). Thus, we simply remand the case to the Commission for further proceedings.

So ordered.

APPENDIX I
BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FCC 01-131

IN THE MATTER OF IMPLEMENTATION OF THE LOCAL COMPETITION PROVISIONS IN THE TELECOMMUNICATIONS ACT OF 1996

CC DOCKET NO. 96-98

INTERCARRIER COMPENSATION FOR ISP-BOUND TRAFFIC

CC DOCKET NO. 99-68

ORDER ON REMAND AND REPORT AND ORDER

ADOPTED: APRIL 18, 2001

RELEASED: APRIL 27, 2001

By the Commission: Chairman Powell issuing a statement; Commissioner Furchtgott-Roth dissenting and issuing a statement.

TABLE OF CONTENTS

Paragraph No.

I. INTRODUCTION 1
II. EXECUTIVE SUMMARY 3
III. BACKGROUND 9
IV. DISCUSSION 18
A. Background 18
B. Statutory Analysis 23
1. Introduction 24
2. Section 251(g) Excludes Certain Categories of Traffic from the Scope of "Telecommunications" Subject to Section 251(b)(5) 31
3. ISP-Bound Traffic Falls within the Categories Enumerated in Section 251(g) 42
4. Section 251(i) Preserves the Commission's Authority to Regulate Interstate Access Services 48
5. ISP-Bound Traffic Falls Within the Purview of the Commission's Section 201 Authority 52
C. Efficient Intercarrier Compensation Rates and Rate Structures 66
1. CPNP Regimes Have Distorted the Development of Competitive Markets 67
2. Intercarrier compensation for ISP-bound Traffic 77
3. Relationship to Section 251(b)(5) 89
D. Conclusion 95
V. Procedural Matters 96

A. Final Regulatory Flexibility Analysis 96
1. Need for, and Objectives of, this Order on Remand and Report and Order 97
2. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA 99
3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply 103
4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements 109
5. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered 110
VI. Ordering Clauses 112

I. INTRODUCTION

1. In this Order, we reconsider the proper treatment for purposes of intercarrier compensation of telecommunications traffic delivered to Internet service providers (ISPs). We previously found in the *Declaratory Ruling*[1] that such traffic is interstate traffic subject to the jurisdiction of the Commission under section 201 of the Act[2] and is not, therefore, subject to the reciprocal compensation provisions of section 251(b)(5).[3] The Court of Appeals for the District of Columbia Circuit held on appeal, however, that the *Declaratory Ruling* failed adequately to explain why our jurisdictional conclusion was relevant to the applicability of section 251(b)(5) and remanded the issue for further consideration.[4] As explained in more detail below, we modify the analysis that led to our determination that ISP-bound traffic falls outside the scope of section 251(b)(5) and conclude that Congress excluded from the "telecommunications" traffic subject to reciprocal compensation the traffic identified in section 251(g), including traffic destined for ISPs. Having found,

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[1] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; intercarrier compensation for ISP-Bound Traffic, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd 3689 (1999) (*Declaratory Ruling* or *Intercarrier Compensation NPRM*).

[2] *See* 47 U.S.C. § 201, Communications Act of 1934 (the Act), as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). Hereinafter, all citations to the Act and to the 1996 Act will be to the relevant section of the United States Code unless otherwise noted.

[3] 47 U.S.C. § 251(b)(5).

[4] *See Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

although for different reasons than before, that the provisions of section 251(b)(5) do not extend to ISP-bound traffic, we reaffirm our previous conclusion that traffic delivered to an ISP is predominantly interstate access traffic subject to section 201 of the Act, and we establish an appropriate cost recovery mechanism for the exchange of such traffic.

2. We recognize that the existing intercarrier compensation mechanism for the delivery of this traffic, in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets. As we discuss in the *Unified Intercarrier Compensation NPRM*,[5] released in tandem with this Order, such market distortions relate not only to ISP-bound traffic, but may result from any intercarrier compensation regime that allows a service provider to recover some of its costs from other carriers rather than from its end-users. Thus, the *NPRM* initiates a proceeding to consider, among other things, whether the Commission should replace existing intercarrier compensation schemes with some form of what has come to be known as "bill and keep."[6] The *NPRM* also considers

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[5] Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (rel. April 27, 2001) ("*Unified Intercarrier Compensation NPRM*" or "*NPRM*").

[6] "Bill and keep" refers to an arrangement in which neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers from its own end-users the cost of both originating traffic that it delivers to the other network and terminating traffic that it receives from the other network. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection

modifications to existing payment regimes, in which the calling party's network pays the terminating network, that might limit the potential for market distortion. The regulatory arbitrage opportunities associated with intercarrier payments are particularly apparent with respect to ISP-bound traffic, however, because ISPs typically generate large volumes of traffic that is virtually all one-way—that is, delivered to the ISP. Indeed, there is convincing evidence in the record that at least some carriers have targeted ISPs as customers merely to take advantage of these intercarrier payments. Accordingly, in this Order we also take interim steps to limit the regulatory arbitrage opportunity presented by ISP-bound traffic while we consider the broader issues of intercarrier compensation in the *NPRM* proceeding.

II. EXECUTIVE SUMMARY

3. As presaged above, we must wrestle with two difficult issues in this Order: first, whether intercarrier compensation for ISP-bound traffic is governed by section 251 or section 201; and, if the latter, what sort of compensation mechanism should apply. The first question is dif-

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between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 16045 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom., AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); Order on Reconsideration, 11 FCC Rcd 13042 (1996); Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997); *further recon. pending*. Bill and keep does not, however, preclude intercarrier charges for transport of traffic between carriers' networks. *Id.*

ficult because we do not believe it is resolved by the plain language of section 251(b)(5) but, instead, requires us to consider the relationship of that section to other provisions of the statute. Moreover, we recognize the legitimate questions raised by the court with respect to the rationales underlying our regulatory treatment of ISPs and ISP traffic. We seek to respond to those questions in this Order. Ultimately, however, we conclude that Congress, through section 251(g),[7] expressly limited the reach of section 251(b)(5) to exclude ISP-bound traffic. Accordingly, we affirm our conclusion in the *Declaratory Ruling* that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5).

4. Because we determine that intercarrier compensation for ISP-bound traffic is within the jurisdiction of this Commission under section 201 of the Act, it is incumbent upon us to establish an appropriate cost recovery mechanism for delivery of this traffic. Based upon the record before us, it appears that the most efficient recovery mechanism for ISP-bound traffic may be bill and keep, whereby each carrier recovers costs from its own end-users. As we recognize in the *NPRM*, intercarrier compensation regimes that require carrier-to-carrier payments are likely to distort the development of competitive markets by divorcing cost recovery from the ultimate consumer of services. In a monopoly environment, permitting carriers to recover some of their costs from interconnecting carriers might serve certain public policy goals. In order to promote universal service, for example, this Commission historically has capped end-user common line charges and required local exchange carriers to recover any shortfall through per-minute charges

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[7] 47 U.S.C. § 251(g).

assessed on interexchange carriers.[8] These sorts of implicit subsidies cannot be sustained, however, in the competitive markets for telecommunications services envisioned by the 1996 Act. In the *NPRM*, we suggest that, given the opportunity, carriers always will prefer to recover their costs from other carriers rather than their own end-users in order to gain competitive advantage. Thus carriers have every incentive to compete, not on basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers, a troubling distortion that prevents market forces from distributing limited investment resources to their most efficient uses.

5. We believe that this situation is particularly acute in the case of carriers delivering traffic to ISPs because these customers generate extremely high traffic volumes that are entirely one-directional. Indeed, the weight of the evidence in the current record indicates that precisely the types of market distortions identified above are taking place with respect to this traffic. For example, comments in the record indicate that competitive local exchange carriers (CLECs), on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic.[9] Moreover, the traffic imbalances

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[8] Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 15998-99 (1997) (*Access Charge Reform Order*), *aff'd*, *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998).

[9] *See, e.g.*, Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001) (ILECs owed $1.98 billion in reciprocal

for some competitive carriers are in fact much greater, with several carriers terminating more than forty times more traffic than they originate.[10] There is nothing inherently wrong with carriers having substantial traffic imbalances arising from a business decision to target specific types of customers. In this case, however, we believe that such decisions are driven by regulatory opportunities that disconnect costs from end-user market decisions. Thus, under the current carrier-to-carrier recovery mechanism, it is conceivable that a carrier could serve an ISP free of charge and recover all of its costs from originating carriers. This result distorts competition by subsidizing one type of service at the expense of others.

6. Although we believe this arbitrage opportunity is particularly manifest with respect to ISP-bound traffic, we suggest in the *NPRM* that any compensation regime based on carrier-to-carrier payments may create similar market distortions. Accordingly, we initiate an inquiry as to whether bill and keep is a more economically efficient compensation scheme than the existing carrier-to-carrier payment mechanisms. Alternatively, the record developed in that proceeding may suggest modifications to

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compensation to CLECs in 2000). On June 23, 2000, the Commission released a Public Notice seeking comment on the issues raised by the court's remand. *See* Comment Sought on Remand of the Commission's Reciprocal Compensation Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit, CC Docket Nos. 96-98, 99-68, Public Notice, 15 FCC Rcd 11311 (2000) (*Public Notice*). Comments and reply comments filed in response to the *Public Notice* are identified herein as "Remand Comments" and "Remand Reply Comments," respectively. Comments and replies filed in response the 1999 *Intercarrier Compensation NPRM* are identified as "Comments" and "Reply Comments," respectively.

[10] *See, e.g.*, Verizon Remand Comments at 11, 21.

carrier-to-carrier cost recovery mechanisms that address the competitive concerns identified above. Based upon the current record, however, bill and keep appears the preferable cost recovery mechanism for ISP-bound traffic because it eliminates a substantial opportunity for regulatory arbitrage. We do not fully adopt a bill and keep regime in this Order, however, because there are specific questions regarding bill and keep that require further inquiry, and we believe that a more complete record on these issues is desirable before requiring carriers to recover most of their costs from end-users. Because these questions are equally relevant to our evaluation of a bill and keep approach for other types of traffic, we will consider them in the context of the *NPRM*. Moreover, we believe that there are significant advantages to a global evaluation of the intercarrier compensation mechanisms applicable to different types of traffic to ensure a more systematic, symmetrical treatment of these issues.

7. Because the record indicates a need for immediate action with respect to ISP-bound traffic, however, in this Order we will implement an interim recovery scheme that: (i) moves aggressively to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound by lowering payments and capping growth; and (ii) initiates a 36-month transition towards a complete bill and keep recovery mechanism while retaining the ability to adopt an alternative mechanism based upon a more extensive evaluation in the *NPRM* proceeding. Specifically, we adopt a gradually declining cap on the amount that carriers may recover from other carriers for delivering ISP-bound traffic. We also cap the amount of traffic for which any such compensation is owed, in order to eliminate incentives to pursue new arbi-

trage opportunities. In sum, our goal in this Order is decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users, consistent with the tentative conclusion in the *NPRM* that bill and keep is the appropriate intercarrier compensation mechanism for ISP-bound traffic. In this regard, we emphasize that the rate caps we impose are not intended to reflect the costs incurred by each carrier that delivers ISP traffic. Some carriers' costs may be higher; some are probably lower. Rather, we conclude, based upon all of the evidence in this record, that these rates are appropriate limits on the amounts recovered from other carriers and provide a reasonable transition from rates that have (at least until recently) typically been much higher. Carriers whose costs exceed these rates are (and will continue to be) able to collect additional amounts from their ISP customers. As we note above, and explain in more detail below, we believe that such end-user recovery likely is the most efficient mechanism.

8. The basic structure of this transition is as follows:

* Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. Any additional costs incurred must be recovered from end-users. These rates reflect the downward trend in intercarrier compensation rates contained in recently negotiated interconnection agreements, suggesting

that they are sufficient to provide a reasonable transition from dependence on intercarrier payments while ensuring cost recovery.

* We also impose a cap on total ISP-bound minutes for which a local exchange carrier (LEC) may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the 2002 ceiling. These caps are consistent with projections of the growth of dial-up Internet access for the first two years of the transition and are necessary to ensure that such growth does not undermine our goal of limiting intercarrier compensation and beginning a transition toward bill and keep. Growth above these caps should be based on a carrier's ability to provide efficient service, not on any incentive to collect intercarrier payments.

* Because the transitional rates are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic). The rate caps are designed to provide a transition toward bill and

keep, and no transition is necessary for carriers already exchanging traffic at rates below the caps.

* In order to limit disputes and costly measures to identify ISP-bound traffic, we adopt a rebuttable presumption that traffic exchanged between LECs that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic subject to the compensation mechanism set forth in this Order. This ratio is consistent with those adopted by state commissions to identify ISP or other convergent traffic that is subject to lower intercarrier compensation rates. Carriers that seek to rebut this presumption, by showing that traffic above the ratio is not ISP-bound traffic or, conversely, that traffic below the ratio is ISP-bound traffic, may seek appropriate relief from their state commissions pursuant to section 252 of the Act.

* Finally, the rate caps for ISP-bound traffic (or such lower rates as have been imposed by states commissions for the exchange of ISP-bound traffic) apply only if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. An incumbent LEC that does not offer to exchange section 251(b)(5) traffic at these rates must exchange ISP-bound traffic at the state-approved or state-negotiated reciprocal compensation rates reflected in their contracts. The record fails to demonstrate that there are inherent differences between the costs of delivering a voice call to a local end-user and a data call to an ISP, thus the "mirroring" rule we adopt here requires that incumbent LECs pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

III. BACKGROUND

9. In the *Declaratory Ruling* released on February 26, 1999, we addressed the regulatory treatment of ISP-bound traffic. In that order, we reached several conclusions regarding the jurisdictional nature of this traffic, and we proposed several approaches to intercarrier compensation for ISP-bound traffic in an accompanying *Intercarrier Compensation NPRM*. The order, however, was vacated and remanded on appeal.[11] This Order, therefore, again focuses on the regulatory treatment of ISP-bound traffic and the appropriate intercarrier compensation regime for carriers that collaborate to deliver traffic to ISPs.

10. As we noted in the *Declaratory Ruling*, an ISP's end-user customers typically access the Internet through an ISP server located in the same local calling area.[12] Customers generally pay their LEC a flat monthly fee for use of the local exchange network, including connections to their local ISP.[13] They also generally pay their ISP a flat monthly fee for access to the Internet.[14] ISPs then combine "computer processing, information storage, protocol conversion, and routing with transmission to enable users to access Internet content and services."[15]

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[11] *See Bell Atlantic*, 206 F.3d 1.

[12] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[13] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[14] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[15] *Declaratory Ruling*, 14 FCC Rcd at 3691 (citing Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11531 (1998) (*Universal Service Report to Congress*)).

11. ISPs, one class of enhanced service providers (ESPs),[16] also may utilize LEC services to provide their customers with access to the Internet. In the *MTS/WATS Market Structure Order*, the Commission acknowledged that ESPs were among a variety of users of LEC interstate access services.[17] Since 1983, however, the Commission has exempted ESPs from the payment of certain interstate access charges.[18] Consequently

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[16] The Commission defines "enhanced services" as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a). The 1996 Act describes these services as "information services." *See* 47 U.S.C. § 153(20) ("information service" refers to the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."). *See also Universal Service Report to Congress*, 13 FCC Rcd at 11516 (the "1996 Act's definitions of telecommunications service and information service essentially correspond to the pre-existing categories of basic and enhanced services").

[17] MTS and WATS Market Structure, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 711 (1983) (*MTS/WATS Market Structure Order*) (ESPs are "[a]mong the variety of users of access service" and "obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit [their] location and, commonly, another location.").

[18] This policy is known as the "ESP exemption." *See MTS/WATS Market Structure Order*, 97 FCC 2d at 715 (ESPs have been paying local business service rates for their interstate access and would experience rate shock that could affect their viability if full access charges were instead applied); *see also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2633 (1988) (*ESP Exemption Order*) ("the imposition of access charges at this time is

ESPs, including ISPs, are treated as end-users for the purpose of applying access charges and are, therefore, entitled to pay local business rates for their connections to LEC central offices and the public switched telephone network (PSTN).[19] Thus, despite the Commission's understanding that ISPs use *interstate* access services, pursuant to the ESP exemption, the Commission has permitted ISPs to take service under *local* tariffs.

12. The 1996 Act set standards for the introduction of competition into the market for local telephone service, including requirements for interconnection of competing telecommunications carriers.[20] As a result of interconnection and growing local competition, more than one LEC may be involved in the delivery of telecommunications within a local service area. Section 251(b)(5) of the Act addresses the need for LECs to agree to terms for the mutual exchange of traffic over their interconnecting networks. It specifically provides that LECs have the duty to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[21] The Commission determined, in the *Local Competition Order*, that section 251(b)(5) reciprocal compensation obligations "apply only to traffic that originates and ter-

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not appropriate and could cause such disruption in this industry segment that provision of enhanced services to the public might be impaired"); *Access Charge Reform Order*, 12 FCC Rcd at 16133 ("[m]aintaining the existing pricing structure ... avoids disrupting the still-evolving information services industry").

[19] *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. *See also Access Charge Reform Order*, 12 FCC Rcd at 16133-35.

[20] 47 U.S.C. §§ 251-252.

[21] 47 U.S.C. § 251(b)(5).

minates within a local area," as defined by state commissions.[22]

13. As a result of this determination, the question arose whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP in the same local calling area that is served by a competing LEC.[23] The Commission determined at that time that resolution of this question turned on whether ISP-bound traffic "originates and terminates

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[22] *See Local Competition Order*, 11 FCC Rcd at 16013 ("With the exception of traffic to or from a CMRS network, state commissions have the authority to determine what geographic areas should be considered 'local areas' for the purpose of applying reciprocal compensation obligations under section 251(b)(5), consistent with the state commissions' historical practice of defining local service areas for wireline LECs."); *see also* 47 C.F.R. § 51.701(b)(1-2). For CMRS traffic, the Commission determined that reciprocal compensation applies to traffic that originates and terminates within the same Major Trading Area (MTA). *See* 47 C.F.R. § 51.701(b)(2).

[23] *See, e.g.*, Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53922 (1996); Petition for Partial Reconsideration and Clarification of MFS Communications Co., Inc. at 28; Letter from Richard J. Metzger, ALTS, to Regina M. Keeney, Chief, Common Carrier Bureau, FCC (June 20, 1997); Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CCB/CPD 97-30, DA 97-1399 (rel. July 2, 1997); Letter from Edward D. Young and Thomas J. Tauke, Bell Atlantic, to William E. Kennard, Chairman, FCC (July 1, 1998). The Commission later directed parties wishing to make *ex parte* presentations regarding the applicability of reciprocal compensation to ISP-bound traffic to make such filings in CC Docket No. 96-98, the local competition proceeding. *See Ex Parte* Procedures Regarding Requests for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CC Docket No. 96-98, Public Notice, 13 FCC Rcd. 15568 (1998).

within a local area," as set forth in our rule.[24] Many competitive LECs argued that ISP-bound traffic is local traffic that terminates at the ISP's local server, where a second, packet-switched "call" then begins.[25] Thus, they argued, the reciprocal compensation obligations of section 251(b)(5) apply to this traffic. Incumbent LECs, on the other hand, argued that no reciprocal compensation is due because ISP-bound traffic is interstate telecommunications traffic that continues through the ISP server and terminates at the remote Internet sites accessed by ISP customers.[26]

14. The Commission concluded in the *Declaratory Ruling* that the jurisdictional nature of ISP-bound traffic should be determined, consistent with Commission precedent, by the end points of the communication.[27] Applying this "end-to-end" analysis, the Commission determined that Internet communications originate with the ISP's end-user customer and continue beyond the local ISP server to websites or other servers and routers that are often located outside of the state.[28] The Commission found, therefore, that ISP-bound traffic is not local because it does not "originate[] and terminate[] within a

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[24] *Declaratory Ruling*, 14 FCC Rcd at 3693-94.

[25] *Declaratory Ruling*, 14 FCC Rcd at 3694.

[26] *Declaratory Ruling*, 14 FCC Rcd at 3695.

[27] *Declaratory Ruling*, 14 FCC Rcd at 3695-3701; *see also* Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation, Memorandum Opinion and Order, 7 FCC Rcd 1619 (1992) (*BellSouth MemoryCall*), *aff'd*, *Georgia Pub. Serv. Comm'n v. FCC*, 5 F.3d 1499 (11th Cir. 1993) (table); *Teleconnect Co. v. Bell Telephone Co. of Penn.*, E-88-83, 10 FCC Rcd 1626 (1995) (*Teleconnect*), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997).

[28] *Declaratory Ruling*, 14 FCC Rcd at 3695-97.

local area."[29] Instead, it is jurisdictionally mixed and largely interstate, and, for that reason, the Commission found that the reciprocal compensation obligations of section 251(b)(5) do not apply to this traffic.[30]

15. Despite finding that ISP-bound traffic is largely interstate, the Commission concluded that it had not yet established a federal rule to govern intercarrier compensation for this traffic.[31] The Commission found that, in the absence of conflicting federal law, parties could voluntarily include ISP-bound traffic in their interconnection agreements under sections 251 and 252 of the Act.[32] It also found that, even though section 251(b)(5) does not *require* reciprocal compensation for ISP-bound traffic, nothing in the statute or our rules prohibits state commissions from determining in their arbitrations that reciprocal compensation for this traffic is appropriate, so long as there is no conflict with governing federal law.[33] Pending adoption of a federal rule, therefore, state commissions exercising their authority under section 252 to arbitrate, interpret, and enforce interconnection agreements would determine whether and how interconnecting carriers should be compensated for carrying ISP-bound traffic.[34] In the

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[29] *Declaratory Ruling*, 14 FCC Rcd at 3697.

[30] *Declaratory Ruling*, 14 FCC Rcd at 3690, 3695-3703.

[31] *Declaratory Ruling*, 14 FCC Rcd at 3703.

[32] *Declaratory Ruling*, 14 FCC Rcd at 3703.

[33] *Declaratory Ruling*, 14 FCC Rcd at 3706.

[34] *Declaratory Ruling*, 14 FCC Rcd at 3703-06. The Commission did recognize, however, that its conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusions that reciprocal compensation is due to the extent that those conclusions were based on a finding that this traffic terminates at the ISP's server. *Id.* at 3706.

Intercarrier Compensation NPRM accompanying the *Declaratory Ruling*, the Commission requested comment on the most appropriate intercarrier compensation mechanism for ISP-bound traffic.[35]

16. On March 24, 2000, prior to release of a decision addressing these issues, the court of appeals vacated certain provisions of the *Declaratory Ruling* and remanded the matter to the Commission.[36] The court observed that, although "[t]here is no dispute that the Commission has historically been justified in relying on this [end-to-end] method when determining whether a particular communication is jurisdictionally interstate,"[37] the Commission had not adequately explained why the jurisdictional analysis was dispositive of, or indeed relevant to, the question whether a call to an ISP is subject to the reciprocal compensation requirements of section 251(b)(5).[38] The court noted that the Commission had not applied its definition of "termination" to its analysis of the scope of section 251(b)(5),[39] and the court distinguished cases upon which the Commission relied in its end-to-end analysis because they involve continuous communications switched by interexchange carriers (IXCs), as opposed to ISPs, the latter of which are not telecommunications providers.[40] As an "independent reason" to vacate, the court also held that the Commission had failed to address

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[35] *Declaratory Ruling*, 14 FCC Rcd at 3707-09.

[36] *See Bell Atlantic*, 206 F.3d 1.

[37] *Bell Atlantic*, 206 F.3d at 5.

[38] *Bell Atlantic*, 206 F.3d at 5; *see also id.* at 8 (the Commission had not "supplied a real explanation for its decision to treat end-to-end analysis as controlling" with respect to the application of section 251(b)(5)).

[39] *See Bell Atlantic*, 206 F.3d at 6-7.

[40] *See Bell Atlantic*, 206 F.3d at 6-7.

how its conclusions "fit . . . within the governing statute."[41] In particular, the court found that the Commission had failed to explain why ISP-bound traffic was not "telephone exchange service," as defined in the Act.[42]

17. In a public notice released June 23, 2000, the Commission sought comment on the issues raised by the court's remand.[43] The *Public Notice* specifically requested that parties comment on the jurisdictional nature of ISP-bound traffic, the scope of the reciprocal compensation requirement of section 251(b)(5), and the relevance of the concepts of "termination," "telephone exchange service," "exchange access service," and "information access."[44] It invited parties to update the record by responding to any *ex parte* presentations filed after the close of the reply period on April 27, 1999. It also sought comment on any new or innovative intercarrier compensation arrangements for ISP-bound traffic that parties may have considered or entered into during the pendency of the proceeding.

IV. DISCUSSION

A. Background

18. The nature and character of communications change over time. Over the last decade communications services have been radically altered by the advent of the Internet and the nature of Internet communications. Indeed, the Internet has given rise to new forms of communications such as e-mail, instant messaging, and other forms of digital, IP-based services. Many of these new

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[41] *Bell Atlantic*, 206 F.3d at 8.

[42] *Bell Atlantic*, 206 F.3d at 8-9; 47 U.S.C. § 153(47) (defining "telephone exchange service").

[43] *Public Notice*, 15 FCC Rcd 11311.

[44] *Id.*; *see also* 47 U.S.C. § 251(g); 47 U.S.C. § 153(20).

services and formats have been layered over and integrated with the existing public telephone systems. Most notably, Internet service providers have come into existence in order to facilitate mass market access to the Internet. A consumer with access to a standard phone line is able to communicate with the Internet, because an ISP converts the analog signal to digital and converts the communication to the IP protocol. This allows the user to access the global Internet infrastructure and communicate with users and websites throughout the world. In a narrowband context, the ISP facilitates access to this global network.

19. The Commission has struggled with how to treat Internet traffic for regulatory purposes, given the bevy of its rules premised on the architecture and characteristics of the mature public switched telephone network. For example, Internet consumers may stay on the network much longer than the design expectations of a network engineered primarily for voice communications. Additionally, the "bursty" nature of packet-switched communications skews the traditional assumptions of per minute pricing to which we are all accustomed. The regulatory challenges have become more acute as Internet usage has exploded.[45]

20. The issue of intercarrier compensation for Internet-bound traffic with which we are presently wrestling is a manifestation of this growing challenge. Traditionally, telephone carriers would interconnect with each other to deliver calls to each other's customers. It was generally assumed that traffic back and forth on these

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[45] *See* Digital Economy 2000, U.S. Department of Commerce (June 2000) ("Three hundred million people now use the Internet, compared to three million in 1994.")

interconnected networks would be relatively balanced. Consequently, to compensate interconnecting carriers, mechanisms like reciprocal compensation were employed, whereby the carrier whose customer initiated the call would pay the other carrier the costs of using its network.

21. Internet usage has distorted the traditional assumptions because traffic to an ISP flows exclusively in one direction, creating an opportunity for regulatory arbitrage and leading to uneconomical results. Because traffic to ISPs flows one way, so does money in a reciprocal compensation regime. It was not long before some LECs saw the opportunity to sign up ISPs as customers and collect, rather than pay, compensation because ISP modems do not generally call anyone in the exchange. In some instances, this led to classic regulatory arbitrage that had two troubling effects: (1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services, potentially driving ISP rates to consumers to uneconomical levels. These effects prompted the Commission to consider the nature of ISP-bound traffic and to examine whether there was any flexibility under the statute to modify and address the pricing mechanisms for this traffic, given that there is a federal statutory provision authorizing reciprocal compensation.[46] In the *Declaratory Ruling*, the Commission concluded that Internet-bound traffic was jurisdictionally interstate and, thus, not subject to section 251(b)(5).

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[46] 47 U.S.C. § 251(b)(5).

22. In *Bell Atlantic*, the court of appeals vacated the *Declaratory Ruling* and remanded the case to the Commission to determine whether ISP-bound traffic is subject to statutory reciprocal compensation requirements. The court held that the Commission failed to explain adequately why LECs did not have a duty to pay reciprocal compensation under section 251(b)(5) of the Act and remanded the case to the Commission.

B. Statutory Analysis

23. In this section, we reexamine our findings in the *Declaratory Ruling* and conclude that ISP-bound traffic is not subject to the reciprocal compensation requirement in section 251(b) because of the carve-out provision in section 251(g), which excludes several enumerated categories of traffic from the universe of "telecommunications" referred to in section 251(b)(5). We explain our rationale and the interrelationship between these two statutory provisions in more detail below. We further conclude that section 251(i) affirms the Commission's role in continuing to develop appropriate pricing and compensation mechanisms for traffic—such as Internet-bound traffic—that travels over convergent, mixed, and new types of network architectures.

1. Introduction

24. In the *Local Competition Order*, the Commission determined that the reciprocal compensation provisions of section 251(b)(5) applied only to what it termed "local" traffic rather than to the transport and termination of interexchange traffic.[47] In the subsequent *Declaratory Ruling*, the Commission focused its discussion on whether ISP-bound traffic terminated within a local calling area such as to be properly considered "local" traffic. To

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[47] *Local Competition Order*, 11 FCC Rcd at 16012.

resolve that issue, the Commission focused predominantly on an end-to-end jurisdictional analysis.

25. On review, the court accepted (without necessarily endorsing) the Commission's view that traffic was either "local" or "long distance" but faulted the Commission for failing to explain adequately why ISP-bound traffic was more properly categorized as long distance, rather than local. The Commission had attempted to do so by employing an end-to-end jurisdictional analysis of ISP traffic, rather than by evaluating the traffic under the statutory definitions of "telephone exchange service" and "exchange access." After acknowledging that the Commission "has historically been justified in relying on" end-to-end analysis for determining whether a communication is jurisdictionally interstate, the court stated: "But [the Commission] has yet to provide an explanation of why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs."[48] After reviewing the manner in which the Commission analyzed the parameters of section 251(b)(5) traffic in the *Declaratory Ruling*, the court found that the central issue was "whether a call to an ISP is local or long distance."[49] The court noted further that "[n]either category fits clearly."[50]

26. Upon further review, we find that the Commission erred in focusing on the nature of the service (*i.e.*, local or long distance) and in stating that there were only two forms of telecommunications services—telephone

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[48] *Bell Atlantic*, 206 F.3d at 5.

[49] *Id.*

[50] *Id.*

exchange service and exchange access—for purposes of interpreting the relevant scope of section 251(b)(5).[51] Those services are the only two expressly defined by the statute. The court found fault in the Commission's failure to analyze communications delivered by a LEC to an ISP in terms of these definitions.[52] Moreover, it cited the Commission's own confusing treatment of ISP-bound traffic as local under the ESP exemption and interstate for jurisdictional purposes.[53]

27. Part of the ambiguity identified by the court appears to arise from the ESP exemption, a long-standing Commission policy that affords one class of entities using interstate access—information service providers—*the option* of purchasing interstate access services on a flat-rated basis from intrastate local business tariffs, rather than from interstate access tariffs used by IXCs. Typically, information service providers have used this exemption to their advantage by choosing to pay local business rates, rather than the tariffed interstate access charges that other users of interstate access are required to pay.[54] In fending off challenges from those who argued that information service providers must be subject to access charges because they provide interexchange service, the Commission has often tried to walk the subtle line of arguing that the service provided by the LEC to the information service provider is an access service, but can

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[51] *Id.* at 8.

[52] *Id.* at 8-9.

[53] *Id.*

[54] Significantly, however, the compensation mechanism effected for this predominantly interstate access traffic is the result of a federal mandate, which requires states to treat ISP-bound traffic for compensation purposes in a manner similar to local traffic if ISPs so request. *See infra* note 105.

justifiably be treated as akin to local telephone exchange service for purposes of the rates the LEC may charge. This balancing act reflected the historical view that there were only two kinds of intercarrier compensation: one for local telephone exchange service, and a second (access charges) for long distance services. Attempting to describe a hybrid service (the nature being an access service, but subject to a compensation mechanism historically limited to local service) was always a bit of mental gymnastics.

28. The court opinion underscores a tension between the jurisdictional nature of ISP-bound traffic, which the Commission has long held to be interstate, and the alternative compensation mechanism that the ESP exemption has permitted for this traffic. The court seems to recognize that, if an end-to-end analysis were properly applied to this traffic, this traffic would be predominantly interstate, and consequently "long distance." Yet it also questions whether this traffic should be considered "local" for purposes of section 251(b)(5) in light of the ESP exemption, by which the Commission has allowed information service providers at their option to be treated for compensation purposes (but *not* for jurisdictional purposes) as end-users.

29. The court also expresses consternation over what it perceives as an inconsistency in the Commission's reasoning. On the one hand, the court observes, the Commission has argued that calls to ISPs are predominantly interstate for jurisdictional purposes because they terminate at the ultimate destination of the traffic in a distant website or e-mail server (*i.e.*, the "one call theory"). On the other hand, the court notes, the Commission has defended the ESP exemption by analogizing an ISP to a high-volume business user, such as a pizza parlor or trav-

el agent, that has different usage patterns and longer call holding times than the average customer.[55] The court questioned whether any such differences should not, as some commenters argued, lend support to treating this traffic as "local" for purposes of section 251(b)(5). As discussed in further detail below, while we continue to believe that retaining the ESP exemption is important in order to facilitate growth of Internet services, we conclude in section IV.C.1, *infra*, that reciprocal compensation for ISP-bound traffic distorts the development of competitive markets.

30. We respond to the court's concerns, and seek to resolve these tensions, by reexamining the grounds for our conclusion that ISP-bound traffic falls outside the scope of section 251(b)(5). A more comprehensive review of the statute reveals that Congress intended to exempt certain enumerated categories of service from section 251(b)(5) when the service was provided to interexchange carriers or information service providers. The exemption focuses not only on the nature of the service, but on to whom the service is provided. For services that qualify, compensation is based on rules, regulations, and policies that preceded the 1996 Act and not on section 251(b)(5), which was minted by the Act. As we explain more fully below, the service provided by LECs to deliver traffic to an ISP constitutes, at a minimum, "information access" under section 251(g) and, thus, compensation for this service is not governed by section 251(b)(5), but instead

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[55] *Access Charge Reform Order*, 12 FCC Rcd at 16134 ("Internet access does generate different usage patterns and longer call holding times than average voice usage.").

by the Commission's policies for this traffic and the rules adopted under its section 201 authority.[56]

2. Section 251(g) Excludes Certain Categories of Traffic from the Scope of "Telecommunications" Subject to Section 251(b)(5)

a. Background

31. Section 251(b)(5) imposes a duty on all local exchange carriers to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[57] On its face, local exchange carriers are required to establish reciprocal compensation arrangements for the transport and termination of *all* "telecommunications" they exchange with another telecommunications carrier, without exception. The Act separately defines "telecommunications" as the "transmission, between or among points specified by the user, of infor-

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[56] Some critics of the Commission's order may contend that we rely here on the same reasoning that the court rejected in *Bell Atlantic*. We acknowledge that there is a superficial resemblance between the Commission's previous order and this one: Here, as before, the Commission finds that ISP-bound traffic falls outside the scope of section 251(b)(5)'s reciprocal compensation requirement and within the Commission's access charge jurisdiction under section 201(b). The rationale underlying the two orders, however, differs substantially. Here the Commission bases its conclusion that ISP-bound traffic falls outside section 251(b)(5) on its construction of sections 251(g) and (i)—not, as in the previous order, on the theory that section 251(b)(5) applies only to "local" telecommunications traffic and that ISP-bound traffic is interstate. Furthermore, to the extent the Commission continues to characterize ISP-bound traffic as interstate for purposes of its section 201 authority, it has sought in this Order to address in detail the *Bell Atlantic* court's concerns.

[57] 47 U.S.C. § 251(b)(5).

mation of the user's choosing, without change in the form or content of the information as sent and received."[58]

32. Unless subject to further limitation, section 251(b)(5) would require reciprocal compensation for transport and termination of *all* telecommunications traffic,—*i.e.*, whenever a local exchange carrier exchanges telecommunications traffic with another carrier. Farther down in section 251, however, Congress explicitly exempts certain telecommunications services from the reciprocal compensation obligations. Section 251(g) provides:

> On or after the date of enactment of the Telecommunications Act of 1996, each local exchange carrier . . . shall provide exchange access, *information access*, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the [Federal Communications] Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment.[59]

33. The meaning of section 251(g) is admittedly not transparent. Indeed, section 251(g) clouds any plain reading of section 251(b)(5). Nevertheless, the Commission believes the two provisions can be read together

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[58] 47 U.S.C. § 153(43).

[59] 47 U.S.C. § 251(g) (emphasis added).

consistently and in a manner faithful to Congress's intent.[60]

b. Discussion

34. We conclude that a reasonable reading of the statute is that Congress intended to exclude the traffic listed in subsection (g) from the reciprocal compensation requirements of subsection (b)(5).[61] Thus, the statute does not mandate reciprocal compensation for "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers. Because we interpret subsection (g) as a carve-out provision, the focus of our inquiry is on the universe of traffic that falls within subsection (g) and *not* the universe of traffic that falls within subsection (b)(5). This analysis differs from our analysis in the *Local Competition Order*, in which we attempted to describe the universe of traffic that falls within subsection (b)(5) as all "local" traffic. We also refrain from generically describing traffic as "local" traffic because the term

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[60] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999) ("It would be a gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. . . . But Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency. . . . We can only enforce the clear limits that the 1996 Act contains.").

[61] In the *Declaratory Ruling*, the Commission did not explain the relevance of section 251(g) nor discuss the categories of traffic exempted from reciprocal compensation by that provision, at least until the Commission should act otherwise. Reflecting this omission in the underlying order, the *Bell Atlantic* court does not mention the relationship of sections 251(g) and 251(b)(5), nor the enumerated categories of services referenced by subsection (g). Rather, the court focuses its review on the possible categorization of ISP-bound traffic as "local," terminology we now find inappropriate in light of the more express statutory language set forth in section 251(g).

"local," not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g).

35. We agree with the court that the issue before us requires more than just a jurisdictional analysis. Indeed, as the court recognized, the 1996 Act changed the historic relationship between the states and the federal government with respect to pricing matters.[62] Instead, we focus upon the statutory language of section 251(b) as limited by 251(g). We believe this approach is not only consistent with the statute, but that it resolves the con cerns expressed by the court in reviewing our previous analysis. Central to our modified analysis is the recognition that 251(g) is properly viewed as a limitation on the scope of section 251(b)(5) and that ISP-bound traffic falls under one or more of the categories set forth in section 251(g). For that reason, we conclude that ISP-bound traffic is not subject to the reciprocal compensation provisions of section 251(b)(5). We reach that conclusion regardless of the compensation mechanism that may be in place for such traffic under the ESP exemption.

36. We believe that the specific provisions of section 251(g) demonstrate that Congress did not intend to interfere with the Commission's pre-Act authority over "nondiscriminatory interconnection . . . obligations (including receipt of compensation)"[63] with respect to "exchange

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[62] *Bell Atlantic*, 206 F.3d at 6; *see also AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 377-87.

[63] Authority over rates (or "receipt of compensation") is a core feature of "equal access and nondiscriminatory interconnection" obligations. Indeed, one of the Commission's primary goals when designing an access charge regime was to ensure that access users were treated in a nondiscriminatory manner when interconnecting with

access, information access, and exchange services for such access" provided to IXCs or information service providers. We conclude that Congress specifically exempted the services enumerated under section 251(g) from the newly imposed reciprocal compensation requirement in order to ensure that section 251(b)(5) is not interpreted to override either existing or future regulations prescribed by the Commission.[64] We also find that ISP-

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LEC networks in order to transport interstate communications. *See National Ass'n of Regulatory Util. Comm'nrs v. FCC*, 737 F.2d 1095, 1101-1108, 1130-34 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985) (*NARUC v. FCC*).

[64] This view is consistent with previous Commission orders construing section 251(g). The Commission recognized in the *Advanced Services Remand Order*, for example, that section 251(g) preserves the requirements of the AT&T Consent Decree (*see United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982) (hereinafter AT&T Consent Decree or Modification of Final Judgment ("MFJ"), but that order does not conclude that section 251(g) preserves *only* MFJ requirements. Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147 et al., Order on Remand, 15 FCC Rcd 385, 407 (1999) (*Advanced Services Remand Order*). Indeed, the ultimate issue addressed in that part of the order was *not* the status or scope of section 251(g) as a carve-out provision at all, but rather the question—irrelevant for our purposes here—whether "information access" is a category of service that is mutually exclusive of "exchange access," as the latter term is defined in section 3(16) of the Act. *See id.* at 407-08; *see also infra* para. 42 & note 76. By contrast, when the Commission first addressed the scope of the reciprocal compensation obligations of section 251(b)(5) in the *Local Competition Order*, it expressly cited section 251(g) in support of the decision to exempt from those obligations the tariffed interstate access services provided by all LECs (not just Bell companies subject to the MFJ) to interexchange carriers. 11 FCC Rcd at 16013. The *Bell Atlantic* court did not take issue with the Commission's earlier conclusion that section 251(b)(5) is so limited. 206 F.3d at 4. The interpretation we adopt here—that section 251(g) exempts from section 251(b)(5) information access services provided to information service providers, as well as access provided to

bound traffic falls within at least one of the three enumerated categories in subsection (g).

37. This limitation in section 251(g) makes sense when viewed in the overall context of the statute. All of the services specified in section 251(g) have one thing in common: they are all access services or services associated with access.[65] Before Congress enacted the 1996 Act, LECs provided access services to IXCs and to information service providers in order to connect calls that travel to points—both interstate and intrastate—beyond the local exchange. In turn, both the Commission and the states had in place access regimes applicable to this traffic, which they have continued to modify over time. It makes sense that Congress did not intend to disrupt these pre-existing relationships.[66] Accordingly, Congress

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IXCs—thus is fully consistent with the Commission's initial construction of section 251(g), in the *Local Competition Order*, as extending beyond the MFJ to *our own* access rules and policies.

[65] The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ. Rather, the term "exchange service" is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purpose of originating or terminating interexchange telecommunications." *United States v. AT&T*, 552 F. Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. Consistent with that, in section 251(g), the term is used as part of the longer phrase "exchange services for such [exchange] access to interexchange carriers and information service providers." The phrasing in section 251(g) thus parallels the MFJ. All of this indicates that the term "exchange service" is closely related to the provision of exchange access and information access.

[66] Although section 251(g) does not itself compel this outcome with respect to *intrastate* access regimes (because it expressly preserves only *the Commission's* traditional policies and authority over interstate access services), it nevertheless highlights an ambiguity in the scope of "telecommunications" subject to section 251(b)(5)– demon-

excluded all such access traffic from the purview of section 251(b)(5).

38. At least one court has already affirmed the principle that the standards and obligations set forth in section 251 are not intended automatically to supersede the Commission's authority over the services enumerated under section 251(g). This question arose in the Eighth Circuit Court of Appeals with respect to the access that LECs provide to IXCs to originate and terminate interstate long-distance calls. Citing section 251(g), the court concluded that the Act contemplates that "LECs will continue to provide exchange access to IXCs for long-distance service, and continue to receive payment, under the *pre-Act* regulations and rates."[67] In *CompTel*, the IXCs had argued that the interstate access services that LECs provide properly fell within the scope of "interconnection" under section 251(c)(2), and that, notwithstanding the carve-out of section 251(g), access charges therefore should be governed by the cost-based standard of section 252(d)(1), rather than determined under the Commission's section 201 authority. The Eighth Circuit rejected that argument, holding that access service does

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strating that the term must be construed in light of other provisions in the statute. In this regard, we again conclude that it is reasonable to interpret section 251(b)(5) to exclude traffic subject to parallel intrastate access regulations, because "it would be incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms." *Local Competition Order*, 11 FCC Rcd at 15869.

[67] *CompTel*, 117 F.3d at 1073 (emphasis added). The court continued that the Commission would be free under section 201 to alter its traditional regulatory treatment of interstate access service in the future, but that the standards set out in sections 251 and 252 would *not* be controlling. *Id.*

not fall within the scope of section 251(c)(2), and observing that "it is clear from the Act that Congress did *not* intend all access charges to move to cost-based pricing, at least not immediately."[68] Neither the court nor the parties in *CompTel* distinguished between the situation in which *one LEC* provides access service (directly linking the end-user to the IXC) and the situation here in which *two LECs* collaborate to provide access to either an information service provider or IXC. In both circumstances, by its underlying rationale, *CompTel* serves as precedent for establishing that pre-existing regulatory treatment of the services enumerated under section 251(g) are carved out from the purview of section 251(b).

39. Accordingly, unless and until the Commission by regulation should determine otherwise, Congress preserved the pre-Act regulatory treatment of all the access services enumerated under section 251(g). These services thus remain subject to Commission jurisdiction under section 201 (or, to the extent they are *intra*state services, they remain subject to the jurisdiction of state commissions), whether those obligations implicate pricing policies as in *CompTel* or reciprocal compensation.[69] This analysis properly applies to the access services that incumbent LECs provide (either individually or jointly with other local carriers) to connect subscribers with ISPs for Internet-bound traffic. Section 251(g) expressly preserves the Commission's rules and policies governing

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[68] *CompTel*, 117 F.3d at 1072 (emphasis added).

[69] For further discussion of the jurisdictionally interstate nature of ISP-bound traffic, *see infra* paras. 55-64. *See also NARUC v. FCC*, 737 F.2d at 1136 (determining that traffic to ESPs may properly constitute interstate access traffic); Access Billing Requirements for Joint Service Provision, CC Docket 87-579, Memorandum Opinion and Order, 4 FCC Rcd 7183 (1989).

"access . . . to information service providers" in the same manner as rules and policies governing access to IXCs.[70] As we discuss in more detail below, ISP-bound traffic falls under the rubric of "information access," a legacy term carried over from the MFJ.[71]

40. By its express terms, of course, section 251(g) permits the Commission to supersede pre-Act requirements for interstate access services. Therefore the Commission may make an affirmative determination to adopt rules that subject such traffic to obligations different

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[70] The Commission has historically dictated the pricing policies applicable to services provided by LECs to information service providers, although those policies differ from those applicable to LEC provision of access services to IXCs. Prior to the 1996 Act, it was the Commission that determined that ESPs either may purchase their interstate access services from interstate tariffs or (at their discretion) pay a combination of local business line rates, the federal subscriber line charges associated with those business lines, and, where appropriate, the *federal* special access surcharge. *See* note 105, *infra*. We conclude that section 251(g) preserves our ability to continue to dictate the pricing policies applicable to this category of traffic. We do not believe, moreover, that section 251(g) extends only to those specific carriers providing service on February 7, 1996. At the very least, subsection (g) is ambiguous on this point. On the one hand, the first sentence of this provision states that its terms apply to "each local exchange carrier, to the extent that it provides wireline services," without regard to whether it may be a BOC or a competitive LEC. 47 U.S.C. § 251(g). On the other hand, that same sentence refers to restrictions and obligations applicable to "such carrier" prior to February 8, 1996. *Id.* We believe that the most reasonable interpretation of that sentence, in this context, is that subsection (g) was intended to preserve pre-existing regulatory treatment for the enumerated *categories* of carriers, rather than requiring disparate treatment depending upon whether the LEC involved came into existence before or after February 1996.

[71] *See United States v. AT&T*, 552 F. Supp. at 229; *Advanced Services Remand Order*, 15 FCC Rcd at 406-08.

than those that existed pre-Act. For example, consistent with that authority, the Commission has previously made the affirmative determination that certain categories of interstate access traffic should be subject to section 251(c)(4).[72] Similarly, in implementing section 251(c)(3), the Commission has required incumbent LECs to unbundle certain network elements used in the provision of xDSL-based services.[73] In this instance, however, for the reasons set forth below,[74] we decline to modify the restraints imposed by section 251(g) and instead continue to regulate ISP-bound traffic under section 201.

41. Some may argue that, although the Commission did not analyze subsection (g) in the *Declaratory Ruling*, a passing reference to section 251(g) in one paragraph of the Commission's brief filed with the court in that proceeding suggests that the argument we make here has been specifically rejected by the court. We disagree. Because our analysis of subsection (g) was not raised in the order, the court, under established precedent, probably

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[72] *See* Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, Second Report and Order, 14 FCC Rcd 19237 (1997), *petition for review pending, Ass'n of Communications Enterprises v. FCC*, D.C. Circuit No. 00-1144. In effect, we have provided for concurrent authority under that provision and section 201 by permitting a party to purchase the same service under filed tariffs or to proceed under interconnection arrangements to secure resale services.

[73] *See* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3775 (1999). *See also Advanced Services Remand Order*, 15 FCC Rcd at 385, 386. We emphasize that these two examples are illustrative and may not be the only instances where the Commission chooses to supersede pre-Act requirements for interstate access services.

[74] *See infra* paras. 67-71.

did not consider the argument when rendering its decision.[76] Indeed, subsection (g) is not mentioned in the court's opinion.

3. ISP-Bound Traffic Falls within the Categories Enumerated in Section 251(g)

42. Having determined that section 251(g) serves as a limitation on the scope of "telecommunications" embraced by section 251(b)(5), the next step in our inquiry is to determine whether ISP-bound traffic falls within one or more of the categories specified in section 251(g): exchange access, information access, and exchange services for such access provided to IXCs and information service providers. Regardless of whether this traffic falls under the category of "exchange access"—an issue pending before the D.C. Circuit in a separate proceeding[77]—we conclude that this traffic, at a minimum, falls under the rubric of "information access," a legacy term imported into the 1996 Act from the MFJ, but not expressly defined in the Communications Act.

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[76] *See, e.g., SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943).

[77] *See Worldcom, Inc. v. FCC*, No. 00-1022 et al. (D.C. Cir.). In that proceeding, the Commission has argued that the category previously labeled "information access" under the MFJ is a subset of those services now falling under the category "exchange access" as set forth in section 3(16) of the Act, 47 U.S.C. 153(16), while incumbent LECs and others have argued that the two categories are mutually exclusive. We need not reargue here whether "information access" is a subset of "exchange access" or whether instead they are mutually exclusive categories. The only issue relevant to our section 251(g) inquiry in this case is whether ISP-bound traffic falls, at a minimum, within the legacy category of "information access." Both the Commission and incumbent LECs have agreed that the access provided to ISPs satisfies the definition of information access.

a. Background

43. Section 251(g) by its terms indicates that, in the provision of exchange access, information access, and exchange services for such access to IXCs and information service providers, various pre-existing requirements and obligations "including receipt of compensation" are preserved, whether these obligations stem from "any court order, *consent decree*, or regulation, order or policy of the Commission." (Emphasis added.) Similarly, in discussing this provision, the Joint Explanatory Statement of the Committee of Conference explicitly refers to preserving the obligations under the "AT&T Consent Decree."[77]

b. Discussion

44. We conclude that Congress's reference to "information access" in section 251(g) was intended to incorporate the meaning of the phrase "information access" as used in the AT&T Consent Decree.[78] The ISP-bound traffic at issue here falls within that category because it is traffic destined for an information service provider.[79] Under the consent decree, "information access" was purchased by "information service providers" and was defined as "the provision of specialized exchange telecommunications services . . . in connection with the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services."[80] We con-

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[77] *Joint Explanatory Statement of the Committee of Conference*, S. Conf. Rep. No. 230, 104th Cong., 2d Session at 123 (February 1, 1996).

[78] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[79] *See* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000) (stating that section 251(g) applies by its very terms to "information access").

[80] *United States v. AT&T*, 552 F. Supp. at 196, 229.

clude that this definition of "information access" was meant to include all access traffic that was routed by a LEC "to or from" providers of information services, of which ISPs are a subset.[81] The record in this proceeding also supports our interpretation.[82] When Congress passed

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[81] This finding is consistent with our past statements on the issue. In the *Non-Accounting Safeguards Order*, we found that the access that LECs provide to enhanced service providers, including ISPs, constitutes "information access" as the MFJ defines that term. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 22024 & n.621 (1996). Although we subsequently overruled our statement in that order that ISPs do not also purchase "exchange access" under section 3(16), we have not altered our finding that the access provided to enhanced service providers (including ISPs) is "information access." *Advanced Services Remand Order*, 15 FCC Rcd at 404-05.

[82] *See, e.g.*, Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000). Some have argued that "information access" includes only certain specialized functions unique to the needs of enhanced service providers and does not include basic telecommunications links used to provide enhanced service providers with access to the LEC network. *See, e.g.*, Brief of WorldCom, Inc., D.C. Circuit No. 00-1002, *et al.*, filed Oct. 3, 2000, at 16 n.12. The MFJ definition of information access, however, includes the telecommunications links used for the "origination, termination, [and] transmission" of information services, *and* "*where necessary*, the provision of network signalling" and other functions. *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Others have argued that the "information access" definition engrafts a geographic limitation that renders this service category a subset of telephone exchange service. *See* Letter from Richard Rindler, Swindler, Berlin, to Magalie Roman Salas, Secretary, FCC, at 3 (Apr. 12, 2001). We reject that strained interpretation. Although it is true that "information access" is necessarily initiated "in an exchange area," the MFJ definition states that the service is provided "*in connection with* the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from

the 1996 Act, it adopted new terminology. The term "information access" is not, therefore, part of the new statutory framework. Because the legacy term "information access" in section 251(g) encompasses ISP-bound traffic, however, this traffic is excepted from the scope of the "telecommunications" subject to reciprocal compensation under section 251(b)(5).

45. We recognize, as noted earlier, that based on the rationale of the *Declaratory Ruling*, the court indicated that the question whether this traffic was "local or interstate" was critical to a determination of whether ISP-bound traffic should be subject to reciprocal compensation.[83] We believe that the court's assessment was a result of our statement in paragraph nine of the *Declaratory Ruling* that "when two carriers collaborate to complete a *local call*, the originating carrier is compensated by its end user and the terminating carrier is entitled to reciprocal compensation pursuant to section 251(b)(5) of the Act."[84] We were mistaken to have characterized the issue in that manner, rather than properly (and more naturally) interpreting the scope of "telecommunications" within section 251(b)(5) as being limited by section 251(g). By indicating that all "local calls," however defined, would be subject to reciprocal compensation obligations under the Act, we overlooked the interplay between these two inter-related provisions of section 251—

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the facilities of a provider of information services" *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Significantly, the definition does not further require that the transmission, once handed over to the information service provider, terminate within the same exchange area in which the information service provider first received the access traffic.

[83] *Bell Atlantic*, 206 F.3d at 5.

[84] *Declaratory Ruling*, 14 FCC Rcd at 3695 (emphasis added).

subsections (b) and (g). Further, we created unnecessary ambiguity for ourselves, and the court, because the statute does not define the term "local call," and thus that term could be interpreted as meaning either traffic subject to local *rates* or traffic that is *jurisdictionally* intrastate. In the context of ISP-bound traffic, as the court observed, our use of the term "local" created a tension that undermined the prior order because the ESP exemption permitted ISPs to purchase access through local business tariffs,[85] yet the jurisdictional nature of this traffic has long been recognized as interstate.

46. For similar reasons, we modify our analysis and conclusion in the *Local Competition Order*.[86] There we held that "[t]ransport and termination of *local* traffic for purposes of reciprocal compensation are governed by sections 251(b)(5) and 251(d)(2)." We now hold that the telecommunications subject to those provisions are all such telecommunications not excluded by section 251(g). In the *Local Competition Order*, as in the subsequent *Declaratory Ruling*, use of the phrase "local traffic" created unnecessary ambiguities, and we correct that mistake here.

47. We note that the exchange of traffic between LECs and commercial mobile radio service (CMRS) providers is subject to a slightly different analysis. In the *Local Competition Order*, the Commission noted its jurisdiction to regulate LEC-CMRS interconnection under section 332 of the Act[87] but decided, at its option, to apply

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[85] This is the compensation mechanism chosen by the ISPs. *See* note 105, *infra*.

[86] *Local Competition Order*, 11 FCC Rcd at 1033-34.

[87] 47 U.S.C. § 332; *Local Competition Order*, 11 FCC Rcd at 16005-06.

sections 251 and 252 to LEC-CMRS interconnection.[88] At that time, the Commission declined to delineate the precise contours of or the relationship between its jurisdiction over LEC-CMRS interconnection under sections 251 and 332,[89] but it made clear that it was not rejecting section 332 as an independent basis for jurisdiction.[90] The Commission went on to conclude that section 251(b)(5) obligations extend to traffic transmitted between LECs and CMRS providers, because the latter are telecommunications carriers.[91] The Commission also held that reciprocal compensation, rather than interstate or intrastate access charges, applies to LEC-CMRS traffic that originates and terminates within the same Major Trading Area (MTA).[92] In so holding, the Commission expressly relied on its "authority under section 251(g) to preserve the current interstate access charge regime" to ensure that interstate access charges would be assessed only for traffic "currently subject to interstate access charges,"[93] although the Commission's section 332 jurisdiction could serve as an alternative basis to reach this result. Thus the analysis we adopt in this Order, that section 251(g) limits the scope of section 251(b)(5), does not affect either the application of the latter section to LEC-CMRS interconnection or our jurisdiction over LEC-CMRS interconnection under section 332.

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[88] *Local Competition Order*, 11 FCC Rcd at 16005-06; *see also Iowa Utils. Bd. v. FCC*, 120 F.3d at 800 n.21 (finding that the Commission had jurisdiction under section 332 to issue rules regarding LEC-CMRS interconnection, including reciprocal compensation rules).

[89] We seek comment on these issues in the *NPRM*.

[90] *Local Competition Order*, 11 FCC Rcd at 16005.

[91] *Id.* at 16016.

[92] *Id.* at 16016-17.

[93] *Id.* at 16017.

4. Section 251(i) Preserves the Commission's Authority to Regulate Interstate Access Services

48. Congress also included a "savings provision"—subpart (i)—in section 251, which provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[94] Under section 201, the Commission has the authority to regulate the *interstate* access services that LECs provide to connect end-users with IXCs or information service providers to originate and terminate calls that travel across state lines.

49. We conclude that subpart (i) provides additional support for our finding that Congress has granted us the authority on a going-forward basis to establish a compensation regime for ISP-bound traffic.[95] When read as a whole, the most natural reading of section 251 is as follows: subsection (b) sets forth reciprocal compensation requirements for the transport and termination of "telecommunications"; subsection (g) excludes certain access services (including ISP-bound traffic) from that requirement; and subsection (i) ensures that, on a going-forward basis, the Commission has the authority to establish pricing for, and otherwise to regulate, interstate access services.

50. When viewed in the overall context of section 251, subsections (g) and (i) serve compatible, but different, purposes. Subsection (g) preserves rules and regulations that existed at the time Congress passed the 1996 Act, and thus functions primarily as a "backward-looking"

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[94] 47 U.S.C. § 251(i).

[95] *See also* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 8 (Dec. 14, 2000).

provision (although it does grant the Commission the authority to supersede existing regulations). In contrast, we interpret section 251(i) to be a "forward-looking" provision. Thus, subsection (i) expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201. This reading of section 251 is consistent with the notion that section 251 generally broadens the Commission's duties, particularly in the pricing context.[96]

51. We expect that, as new network architectures emerge, the nature of telecommunications traffic will continue to evolve. As we have already observed, since Congress passed the 1996 Act, customer usage patterns have changed dramatically; carriers are sending traffic over networks in new and different formats; and manufacturers are adding creative features and developing innovative network architectures. Although we cannot anticipate the direction that new technology will take us, we do expect the dramatic pace of change to continue. Congress clearly did not expect the dynamic, digital broadband driven telecommunications marketplace to be hindered by rules premised on legacy networks and technological assumptions that are no longer valid. Section 251(i), together with section 201, equips the Commission with the tools to ensure that the regulatory environment keeps pace with innovation.

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[96] For example, section 251 has expanded upon our historic functions by providing us with the authority to set the framework for pricing rules applicable to unbundled network elements, purchased under interconnection agreements.

5. ISP-Bound Traffic Falls Within the Purview of the Commission's Section 201 Authority

52. Having found that ISP-bound traffic is excluded from section 251(b)(5) by section 251(g), we find that the Commission has the authority pursuant to section 201 to establish rules governing intercarrier compensation for such traffic. Under section 201, the Commission has long exercised its *jurisdictional* authority to regulate the interstate access services that LECs provide to connect callers with IXCs or ISPs to originate or terminate calls that travel across state lines. Access services to ISPs for Internet-bound traffic are no exception. The Commission has held, and the Eighth Circuit has recently concurred, that traffic bound for information service providers (including Internet access traffic) often has an interstate component.[97] Indeed, that court observed that, although some traffic destined for information service providers (including ISPs) may be intrastate, the interstate and intrastate components cannot be reliably separated.[98] Thus, ISP traffic is properly classified as interstate,[99] and it falls under the Commission's section 201 jurisdiction.[100]

53. In its opinion remanding this proceeding, the court appeared to acknowledge that the end-to-end analysis was appropriate for determining the scope of the

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[97] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 543 (8th Cir. 1998) (affirming the jurisdictionally mixed nature of ISP-bound traffic).

[98] *Id.*

[99] *See, e.g., Louisiana PSC v. FCC*, 476 U.S. 355, 375 n.4.

[100] *See* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC (Dec. 8, 2000) (attaching *A Legal Roadmap for Implementing a Bill and Keep Rule for All Wireline Traffic*, at 10-11) (*Qwest Roadmap*).

Commission's jurisdiction under section 201, stating that "[t]here is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[101] The court nevertheless found that we had not supplied a logical nexus between the jurisdictional end-to-end analysis (which delineates the contours of our section 201 authority) and our interpretation of the scope of section 251(b)(5). In that regard, the court appeared not to question the Commission's long-standing assertion of jurisdiction over ESP traffic, of which Internet-bound traffic is a subset.[102] It did, however, unambiguously question whether, for purposes of interpreting section 251(b)(5), the jurisdictional end-to-end analysis was dispositive. Accordingly, the court explained its basis for remand as follows: "Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling [in interpreting the scope of section 251(b)(5)] . . . we must vacate the ruling and remand the case."[103]

54. As explained above, we no longer construe section 251(b)(5) using the dichotomy set forth in the *Declaratory Ruling* between "local" traffic and interstate traffic. Rather, we have clarified that the proper analysis hinges on section 251(g), which limits the reach of the reciprocal compensation regime mandated in section 251(b). Thus our discussion no longer centers on the jurisdictional inquiry set forth in the underlying order. Nonetheless, we take this opportunity to respond to questions raised

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[101] *Bell Atlantic*, 206 F.3d at 5; *see Qwest Roadmap* at 4.

[102] The D.C. Circuit itself has long recognized that ESPs use interstate access. *See, e.g., NARUC v. FCC*, 737 F.2d at 1136.

[103] *Bell Atlantic*, 206 F.3d at 8.

by the court regarding the differences between ISP-bound traffic (which we have always held to be predominantly interstate for jurisdictional purposes) and intrastate calls to "communications-intensive business end user[s],"[104] such as travel agencies and pizza parlors.

55. Contrary to the arguments made by some IXCs, the Commission has been consistent in its jurisdictional treatment of ISP-bound traffic. For compensation purposes, in order to create a regulatory environment that will allow new and innovative services to flourish, the Commission has exempted enhanced service providers (including ISPs) from paying for interstate access service at the usage-based rates charged to IXCs.[106] The ESP exemption was and remains an affirmative *exercise* of federal regulatory authority over interstate access service under section 201, and, in affirming pricing under that exemption, the D.C. Circuit expressly recognized

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[104] *Bell Atlantic*, 206 F.3d at 7.

[105] As noted, the Commission has permitted ESPs to pay local business line rates from intrastate tariffs for ILEC-provided access service, in lieu of interstate carrier access charges. *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 715; *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. ESPs also pay the *federal* subscriber lines charges associated with those business lines and, where appropriate, the *federal* special access surcharge. The subscriber line charge (SLC) recovers a portion of the cost of a subscriber's line that is allocated, pursuant to jurisdictional separations, to the interstate jurisdiction. *See* 47 C.F.R. § 69.152 (defining SLC); 47 C.F.R. Part 36 (jurisdictional separations). The special access surcharge recovers for use of the local exchange when private line/PBX owners "circumvent the conventional long-distance network and yet achieve interstate connections beyond those envisioned by the private line service." *NARUC v. FCC*, 737 F.2d at 1138. *See* 47 C.F.R. § 69.115.

that ESPs use *interstate* access service.[106] Moreover, notwithstanding the ESP exemption, the Commission has always *permitted* enhanced service providers, including ISPs, to purchase their interstate access out of interstate tariffs—thus underscoring the Commission's consistent view that the link LECs provide to connect subscribers with ESPs is an interstate access service.[107]

56. We do not believe that the court's decision to remand the *Declaratory Ruling* reflects a finding that such traffic constitutes two calls, rather than a single end-to-end call, for jurisdictional purposes. The court expressly acknowledged that "the end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction."[108] The court also said that "[t]here is no dispute

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[106] With judicial approval, the Commission initially adopted this access service pricing policy in order to avoid rate shock to a fledgling enhanced services industry. *NARUC v. FCC*, 737 F.2d at 1136-37. In the decision affirming this pricing policy, the court expressly recognized that ESPs use interstate access service. *Id.* at 1136 (enhanced service providers "may, at times, heavily use exchange access"). The Commission recently decided to retain this policy, largely because it found that it made little sense to mandate, for the first time, the application of existing non-cost-based interstate access rates to enhanced services just as the Commission was reforming the access charge regime to eliminate implicit subsidies and to move such charges toward competitive levels. *Access Charge Reform Order*, 12 FCC Rcd at 16133, *aff'd, Southwestern Bell Telephone Co.*, 153 F.3d at 541-42.

[107] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711-12, 722; Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Memorandum Opinion and Order, 4 FCC Rd 1, 141 (1988), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993) (*ONA Plans Order*); GTE Telephone Operating Cos., CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466 (1998).

[108] *Bell Atlantic*, 206 F.3d at 3.

that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[109] And the court appeared to suggest, at least for the sake of argument, that the Commission had not misapplied that analysis *as a jurisdictional matter* in finding that ISP-bound traffic was interstate.[110] We do recognize, however, that the court was concerned by how one would categorize this traffic under our *prior* interpretation of section 251(b)(5), which focused on whether or not ISP-bound calls were "local." That inquiry arguably implicated the compensation mechanism for the traffic (which included a local component), as well as the meaning of the term "termination" in the specific context of section 251(b); but neither of these issues is germane to our assertion of jurisdiction here under our section 201 authority.

57. For jurisdictional purposes, the Commission views LEC-provided access to enhanced services providers, including ISPs, on the basis of the end points of the communication, rather than intermediate points of switching or exchanges between carriers (or other providers).[111] Thus, in the *ONA Plans Order*, the Commission emphasized that "when an enhanced service is inter-

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[109] *Id.* at 5.

[110] *See, e.g., id.* at 6, 7 (accepting, *arguendo*, that ISP-bound traffic is like IXC-bound traffic for jurisdictional purposes).

[111] *See, e.g., BellSouth MemoryCall*, 7 FCC Rcd at 1620 (voicemail is interstate because "there is a continuous path of communications across state line between the caller and the voice mail service"); *ONA Plans Order*, 4 FCC Rcd at 141 (an enhanced service is subject to FCC authority if it is interstate, "that is, when it involves communications or transmissions between points in different states on an end-to-end basis").

state (that is, when it involves communications or transmissions between points in different states on an end-to-end basis), the underlying basic services are subject to [our jurisdiction]."[112] Consistent with that view, when end-to-end communications involving enhanced service providers cross state lines, the Commission has categorized the link that the LEC provides to connect the end-user with an enhanced service provider as interstate access service.[113] Internet service providers are a class of ESPs. Accordingly, the LEC-provided link between an end-user and an ISP is properly characterized as *interstate* access.[114]

58. Most Internet-bound traffic traveling between a LEC's subscriber and an ISP is indisputably interstate in nature when viewed on an end-to-end basis. Users on the Internet are interacting with a global network of connected computers. The consumer contracts with an ISP

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[112] *ONA Plans Order*, 4 FCC Rcd at 141; *see also id.*, Memorandum Opinion and Order on Reconsideration, 5 FCC Rcd 3084, 3088-89 (1990), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993) (rejecting claim that basic service elements, consisting of features and functions provided by telephone company's local switch for benefit of enhanced service providers and others, are separate intrastate offerings even when used in connection with end-to-end transmissions).

[113] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711 ("[a]mong the variety of users of access service are ... enhanced service providers"); Amendment of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305, 4305, 4306 (1987) (noting that enhanced service providers use "exchange access service"); *ESP Exemption Order*, 3 FCC Rcd at 2631 (referring to "certain classes of exchange access users, including enhanced service providers").

[114] *See, e.g., Access Charge Reform Order*, 12 FCC Rcd at 16131-32; GTE Telephone Operating Cos., 13 FCC Rcd at 22478. *Cf. Bell Atlantic*, 206 F.3d at 4, 6-7.

to provide access to the Internet. Typically, when the customer wishes to interact with a person, content, or computer, the customer's computer calls a number provided by the ISP that is assigned to an ISP modem bank. The ISP modem answers the call (the familiar squelch of computers handshaking). The user initiates a communication over the Internet by transmitting a command. In the case of the web, the user requests a webpage. This request may be sent to the computer that hosts the webpage. In real time, the web host may request that different pieces of that webpage, which can be stored on different servers across the Internet, be sent, also in real time, to the user. For example, on a sports page, only the format of the webpage may be stored at the host computer in Chicago. The advertisement may come from a computer in California (and it may be a different advertisement each time the page is requested), the sports scores may come from a computer in New York City, and a part of the webpage that measures Internet traffic and records the user's visit may involve a computer in Virginia. If the user decides to buy something from this webpage, say a sports jersey, the user clicks on the purchase page and may be transferred to a secure web server in Maryland for the transaction. A single web address frequently results in the return of information from multiple computers in various locations globally. These different pieces of the webpage will be sent to the user over different network paths and assembled on the user's display.[115]

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[115] Of course, the Internet provides applications other than the World Wide Web, such as e-mail, games, chat sites, or streaming media, which have different technical characteristics but all of which involve computers in multiple locations, often across state and national boundaries.

59. The "communication" taking place is between the dial-up customer and the global computer network of web content, e-mail authors, game room participants, databases, or bulletin board contributors. Consumers would be perplexed to learn regulators believe they are communicating with ISP modems, rather than the buddies on their e-mail lists. The proper focus for identifying a communication needs to be the user interacting with a desired webpage, friend, game, or chat room, not on the increasingly mystifying technical and mechanical activity in the middle that makes the communication possible.[116] ISPs, in most cases, provide services that permit the dial-up Internet user to communicate directly with some distant site or party (other than the ISP) that the caller has specified.

60. ISP service is analogous, though not identical, to long distance calling service. An AT&T long distance customer contracts with AT&T to facilitate communications to out-of-state locations. The customer uses the local network to reach AT&T's facilities (its point of presence). By dialing "1" and an area code, the customer is in essence addressing his call to an out of state party and is instructing his LEC to deliver the call to his long distance carrier, and instructing the long distance carrier to pick up and carry that call to his intended destination. The caller on the other end will pick up the phone and respond to the caller. The communication will be between these two end-users. This analogy is not meant to prove that ISP service is identical to long distance service, but is used merely to bolster, by analogy, the reasonableness of not characterizing an ISP as the destination of a call, but as a facilitator of communication.

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[116] *See Qwest Roadmap* at 4-5, 9-10.

61. Moreover, as the local exchange carriers have correctly observed, the technical configurations for establishing dial-up Internet connections are quite similar to certain network configurations employed to initiate more traditional long-distance calls.[117] In most cases, an ISP's customer first dials a seven-digit number to connect to the ISP server before connecting to a website. Long-distance service in some network configurations is initiated in a substantially similar manner. In particular, under "Feature Group A" access, the caller first dials a seven-digit number to reach the IXC, and then dials a password and the called party's area code and number to complete the call. Notwithstanding this dialing sequence, the service the LEC provides is considered *interstate* access service, not a separate local call.[118] Internet calls operate in a similar manner: after reaching the ISP's server by dialing a seven-digit number, the caller selects a website (which is identified by a 12-digit Internet address, but which often is, in effect, "speed dialed" by clicking an icon) and the ISP connects the caller to the selected website. Such calling should yield the same jurisdictional result as the analogous calls to IXCs using "Feature Group A" access.

62. Commission precedent also rejects the two-call theory in the context of calls involving enhanced services. In *BellSouth MemoryCall*, the Commission preempted a state commission order that had prohibited BellSouth from expanding its voice mail service—an enhanced ser-

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[117] *See, e.g.*, Verizon Remand Reply at 9 (Internet traffic is indistinguishable from Feature Group A access service).

[118] *See Local Competition Order*, 11 FCC Rcd at 15935 n.2091 (describing "Feature Group A" access service); *see also MCI Telecomm. Corp. v. FCC*, 566 F.2d 365, 367 n.3 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978).

vice—beyond its existing customers.[119] In doing so, it rejected claims by the state that the Commission lacked jurisdiction to preempt because, allegedly, out-of-state calls to the voice mail service really constituted two calls: an *inter*state call from the out-of-state caller to the telephone company switch that routes the call to the intended recipient's location, and a separate *intra*state call that forwards the communication from the switch to the voice mail apparatus in the event that the called party did not answer.[120] The Commission explained that, whether a basic telecommunications service is at issue, or whether an enhanced service rides on the telephone company's telecommunications service, the Commission's jurisdiction does not end at the local switchboard, but continues to the ultimate destination of the call.[121]

63. The Internet communication is not analogous to traditional telephone exchange services. Local calls set up communication between two parties that reside in the same local calling area. Prior to the introduction of local competition, that call would never leave the network of the incumbent LEC. As other carriers were permitted to enter the local market, a call might cross two or more carriers' networks simply because the two parties to the communication subscribed to two different local carriers. The two parties intending to communicate, however, remained squarely in the same local calling area. An Internet communication is not simply a local call from a consumer to a machine that is lopsided, that is, a local call where one party does most of the calling, or most of the talking. ISPs are service providers that technically modi-

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[119] *BellSouth MemoryCall*, 7 FCC Rcd at 1619.

[120] *Id.* at 1620.

[121] *Id.* at 1621.

fy and translate communication, so that their customers will be able to interact with computers across the global Internet.[122]

64. The court in *Bell Atlantic* noted that FCC litigation counsel had differentiated ISP-bound traffic from ordinary long-distance calls by stating that the former "is really like a call to a local business"—such as a pizza delivery firm, a travel reservation agency, a credit card verification firm, or a taxicab company—"that then uses the telephone to order wares to meet the need."[123] We find, however, that this citation to a former litigation position does not require us to alter our analysis. First, the Commission itself has never analogized ISP-bound traffic in the manner cited in the agency's brief in *Southwestern Bell.* Indeed, in the particular order that the Commission was defending in *Southwestern Bell,* the Commission distinguished ISP-bound traffic from other access traffic on *other* grounds—*e.g.*, call direction and call holding times[124]—which have no arguable bearing on whether the traffic is one interstate call (as the Commission has always held) or two separate calls (one of which allegedly is intrastate) as some parties have contended. Second, the cited portion of the Commission's brief was not addressing jurisdiction at all. Rather, the brief was responding to a claim that the ESP exemption *discriminated* against

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[122] It is important to note that a dial-up call to an ISP will not even be required when broadband services arrive. Those connections will be always on and there will be no phone call in any traditional sense. Indeed, the only initiating event will be the end-user interacting with other Internet content or users. Thus, increasingly, notions of two calls become meaningless.

[123] *Bell Atlantic*, 206 F.3d at 8 (citing FCC Brief at 76, *Southwestern Bell v. FCC*, 153 F.3d 523).

[124] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34.

IXCs and in favor of ISPs.[125] Finally, in the very case in which litigation counsel made the cited analogy, the Eighth Circuit affirmed the Commission's consistent view that ISP-bound traffic is, as a *jurisdictional* matter, predominantly interstate.[126] In any event, to the extent that our prior briefs could be read to conceptualize the nature of ISP service as local, akin to intense users of local service, we now embrace a different conceptualization that we believe more accurately reflects the nature of ISP service.

65. For the foregoing reasons, consistent with our longstanding precedent, we find that we continue to have jurisdiction under section 201, as preserved by section 251(i), to provide a compensation mechanism for ISP-bound traffic.

C. Efficient Intercarrier Compensation Rates and Rate Structures

66. Carriers currently recover the costs of call transport and termination through some combination of carrier access charges, reciprocal compensation, and end-user charges, depending upon the applicable regulatory regime. Having concluded that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5), we must now determine, pursuant to our section 201 authority, what compensation mechanism is appropriate when carriers collaborate to deliver calls to ISPs. In the companion *NPRM*, we consider the desirability of adopting a uniform intercarrier compensation mechanism, applicable to all traffic exchanged among telecommunications carriers, and, in that context, we intend to examine the merits of a bill and keep regime for

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[125] *See* FCC Brief at 75-76, *Southwestern Bell v. FCC*, 153 F.3d 523.

[126] *Southwestern Bell v. FCC*, 153 F.3d at 534.

all types of traffic, including ISP-bound traffic. In the meantime, however, we must adopt an interim intercarrier compensation rule to govern the exchange of ISP-bound traffic, pending the outcome of the *NPRM*. In particular, we must decide whether to impose (i) a "calling-party's-network-pays" (CPNP) regime, like reciprocal compensation, in which the calling party's network pays the network serving the ISP; (ii) a bill and keep regime in which all networks recover costs from their end-user customers and are obligated to deliver calls that originate on the networks of interconnecting carriers; or (iii) some other cost recovery mechanism. As set forth more fully below, our immediate goal in adopting an interim compensation mechanism is to address the market distortions created by the prevailing intercarrier compensation regime, even as we evaluate in a parallel proceeding what longer-term intercarrier compensation mechanisms are appropriate for this and other types of traffic.

1. CPNP Regimes Have Distorted the Development of Competitive Markets

67. For the reasons detailed below, we believe that a bill and keep approach to recovering the costs of delivering ISP-bound traffic is likely to be more economically efficient than recovering these costs from originating carriers. In particular, requiring carriers to recover the costs of delivering traffic to ISP customers directly from those customers is likely to send appropriate market signals and substantially eliminate existing opportunities for regulatory arbitrage. As noted above, we consider issues related to the broader application of bill and keep as an intercarrier compensation regime in conjunction with the *NPRM* that we are adopting concurrently with this Order. In this Order, however, we

adopt an interim compensation mechanism for the delivery of ISP-bound traffic that addresses the regulatory arbitrage opportunities present in the existing carrier-to-carrier payments by limiting carriers' opportunity to recover costs from other carriers and requiring them to recover a greater share of their costs from their ISP customers.

68. In most states, reciprocal compensation governs the exchange of ISP-bound traffic between local carriers.[127] Reciprocal compensation is a CPNP regime in which the originating carrier pays an interconnecting carrier for "transport and termination," *i.e.*, for transport from the networks' point of interconnection and for any tandem and end-office switching.[128] The central problem with any CPNP regime is that carriers recover their costs not only from their end-user customers, but also from *other carriers*.[129] Because intercarrier compensation rates do not reflect the degree to which the carrier can recover costs from its end-users, payments from other carriers may enable a carrier to offer service to its customers at rates that bear little relationship to its

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[127] In the *Declaratory Ruling*, we stated that, pending adoption of a federal rule governing intercarrier compensation for ISP-bound traffic, state commissions would determine whether reciprocal compensation was due for such traffic. *Declaratory Ruling*, 14 FCC Rcd at 3706. Since that time, most, though not all, states have ordered the payment of reciprocal compensation for ISP-bound traffic.

[128] 47 C.F.R. § 51.703(a).

[129] Recovery from other carriers is premised on the economic assumption that the carrier whose customer originates the call has "caused" the transport and termination costs associated with that call, and the originating carrier should, therefore, reimburse the interconnecting carrier for "transport and termination." The companion *NPRM* evaluates the validity of that assumption and tentatively concludes that it is an incorrect premise.

actual costs, thereby gaining an advantage over its competitors. Carriers thus have the incentive to seek out customers, including but not limited to ISPs, with high volumes of incoming traffic that will generate high reciprocal compensation payments.[130] To the extent that carriers offer these customers below cost retail rates subsidized by intercarrier compensation, these customers do not receive accurate price signals. Moreover, because the originating LEC typically charges its customers averaged rates, the originating end-user receives inaccurate price signals as the costs associated with the intercarrier payments are recovered through rates averaged across all of the originating carrier's end-users. Thus no subscriber faces a price that fully reflects the intercarrier payments. An ISP subscriber with extensive Internet usage may, for example, cause her LEC to incur substantial reciprocal compensation obligations to the LEC that serves her ISP, but that subscriber receives no price signals reflecting those costs because they are spread over all of her LEC's customers.

69. The resulting market distortions are most apparent in the case of ISP-bound traffic due primarily to the one-way nature of this traffic, and to the tremendous growth in dial-up Internet access since passage of the 1996 Act. Competitive carriers, regardless of the nature of their customer base, exchange traffic with the incumbent LECs at rates based on the incumbents' costs.[131] To

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[130] *Cf. Local Competition Order*, 11 FCC Rcd at 16043 (symmetrical termination payments to paging providers based on ILECs' costs "might create uneconomic incentives for paging providers to generate traffic simply in order to receive termination compensation").

[131] 47 C.F.R. § 51.705 (an incumbent LEC's rates for transport and termination shall be established on the basis of the forward-looking economic costs of such offerings); 47 C.F.R. § 51.711 (subject to

the extent the traffic exchange is roughly balanced, as is typically the case when LECs exchange voice traffic, it matters little if rates reflect costs because payments in one direction are largely offset by payments in the other direction. The rapid growth in dial-up Internet use, however, created the opportunity to serve customers with large volumes of exclusively *incoming* traffic. And, for the reasons discussed above, the reciprocal compensation regime created an incentive to target those customers with little regard to the costs of serving them—because a carrier would be able to collect some or all of those costs from *other* carriers that would themselves be unable to flow these costs through to their own customers in a cost-causative manner.

70. The record is replete with evidence that reciprocal compensation provides enormous incentive for CLECs to target ISP customers. The four largest ILECs indicate that CLECs, on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic.[132] Verizon states that it sends CLECs, on average, twenty-one times more traffic than it receives, and some CLECs receive more than forty

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certain exceptions, rates for transport and termination shall be symmetrical and equal to those that the incumbent LEC assesses upon other carriers for the same services).

[132] Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet-bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001) (ILECs owed $1.98 billion in reciprocal compensation to CLECs in 2000).

times more traffic than they originate.[133] Although there may be sound business reasons for a CLEC's decision to serve a particular niche market, the record strongly suggests that CLECs target ISPs in large part because of the availability of reciprocal compensation payments.[134] Indeed, some ISPs even seek to become CLECs in order to share in the reciprocal compensation windfall, and, for a small number of entities, this revenue stream provided an inducement to fraudulent schemes to generate dial-up minutes.[135]

71. For these reasons, we believe that the application of a CPNP regime, such as reciprocal compensation, to ISP-bound traffic undermines the operation of competitive markets.[136] ISPs do not receive accurate price signals from carriers that compete, not on the basis of the quality and efficiency of the services they provide, but on the basis of their ability to shift costs to other carriers. Efficient prices result when carriers offer the lowest

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[133] Verizon Remand Comments at 11, 21. Verizon also cites extreme cases of CLECs that terminate in excess of *eight thousand* times more traffic than they originate. *Id.* at 21. *See also* Letter from Robert T. Blau, BellSouth; Melissa Newman, Qwest; Priscilla Hill-Ardoin, SBC; and Susanne Guyer, Verizon, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Nov. 9, 2000).

[134] *See, e.g.*, Verizon Remand Comments at 15 (citing case of CLEC offer of free long distance service to dial-up Internet customers, an offer it did not extend to its customers that accessed the Internet via cable modem or DSL service); SBC Remand Comments at 45 (citing examples of CLEC offering free service to ISPs that collocated in its switching centers and CLECs offering to share reciprocal compensation revenues with ISPs).

[135] *See, e.g.*, Verizon Remand Comments at 17-18.

[136] The *NPRM* that we adopt in conjunction with this Order seeks comment on the degree to which a modified CPNP regime might address these concerns.

possible rates based on the costs of the service they provide to ISPs, not when they can price their services without regard to cost. We are concerned that viable, long-term competition among efficient providers of local exchange and exchange access services cannot be sustained where the intercarrier compensation regime does not reward efficiency and may produce retail rates that do not reflect the costs of the services provided. As we explain in greater detail in the companion *NPRM*, we believe that a compensation regime, such as bill and keep, that requires carriers to recover more of their costs from end-users may avoid these problems.

72. We acknowledge that we did not always hold this view. In the *Local Competition Order*, the Commission concluded that state commissions may impose bill and keep arrangements for traffic subject to section 251(b)(5) *only* when the flow of traffic between interconnected carriers is roughly balanced and is expected to remain so.[137] The Commission reasoned that "bill-and-keep arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' *termination* facilities by seeking customers that primarily *originate* traffic."[138] The concerns about the opportunity for cost recovery and economic efficiency are not present, however, to the extent that traffic between carriers is balanced and payments from one carrier will be offset by payments from the other carrier. In these circumstances, the Commission found

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[137] *Local Competition Order*, 11 FCC Rcd at 16054-55; *see also* 47 C.F.R. § 51.713(b).

[138] *Local Competition Order*, 11 FCC Rcd at 16055 (emphases added).

that bill and keep arrangements may minimize administrative burdens and transaction costs.[139]

73. Since that time, we have observed the development of competition in the local exchange market, and we now believe that the Commission's concerns about economic inefficiencies associated with bill and keep missed the mark, particularly as applied to ISP-bound traffic. The Commission appears to have assumed, at least implicitly, that the calling party was the sole cost causer of the call, and it may have overstated any incentives that a bill and keep regime creates to target customers that primarily originate traffic. A carrier must provide originating switching functions and must recover the costs of those functions from the originating end-user, not from other carriers. Originating traffic thus lacks the same opportunity for cost-shifting that reciprocal compensation provides with respect to serving customers with disproportionately incoming traffic. Indeed, it has become apparent that the obligation to pay reciprocal compensation to interconnecting carriers may give rise to uneconomic incentives. As the current controversy about ISP-bound traffic demonstrates, reciprocal compensation encourages carriers to overuse competing carriers' *origination* facilities by seeking customers that *receive* high volumes of traffic.

74. We believe that a bill and keep regime for ISP-bound traffic may eliminate these incentives and concomitant opportunity for regulatory arbitrage by forcing carriers to look only to their ISP customers, rather than to other carriers, for cost recovery. As a result, the rates paid by ISPs and, consequently, their customers should better reflect the costs of services to which they sub-

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[139] *Id.* at 16055.

scribe. Potential subscribers should receive more accurate price signals, and the market should reward efficient providers.[140] Although we do not reach any firm conclusions about bill and keep as a permanent mechanism for this or any other traffic, our evaluation of the record evidence to date strongly suggests that bill and keep is likely to provide a viable solution to the market distortions caused by the application of reciprocal compensation to ISP-bound traffic. We take that observation into account, below, as we fashion an interim compensation mechanism for this traffic.

75. Bill and keep also may address the problem regulators face in setting intercarrier compensation rates that correlate to the costs carriers incur to carry traffic that originates on other networks. The record suggests that market distortions appear to have been exacerbated by the prevalence of excessively high reciprocal compensation rates. Many CLECs argue that the current traffic imbalances between CLECs and ILECs are the product of greediness on the part of ILECs that insisted on above-cost reciprocal compensation rates in the course of negotiating or arbitrating initial interconnection agreements.[141] CLECs argue that, because these rates were artificially high, they naturally responded by seeking customers with large volumes of incoming traffic. If the parties or regulatory bodies merely set cost-based rates and rate structures, they argue, arbitrage opportunities and the resulting windfalls would disappear.[142] They note that

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[140] We also note that bill and keep arrangements are common among entities providing Internet backbone services, where the larger carriers engage in so-called "peering" arrangements.

[141] Time Warner Remand Comments at 15-16.

[142] Time Warner Remand Comments at 16. Some parties suggest that a bifurcated rate structure (a call set-up charge and a minute of

reciprocal compensation rates have fallen dramatically as initial agreements expire and the parties negotiate new agreements.[143]

76. We do not believe that the solution to the current problem is as simple as the CLECs suggest.[144] We seek comment in the accompanying *NPRM* on the potential for a modified CPNP regime, such as the CLECs advocate, to solve some of the problems we identify here. We are convinced, however, that intercarrier payments for ISP-bound traffic have created severe market distortions. Although it would be premature to institute a full bill and keep regime before resolving the questions presented in the *NPRM*,[145] in seeking to remedy an exigent market problem, we cannot ignore the evidence we have accumulated to date that suggests that a bill and keep regime has very fundamental advantages over a CPNP regime for ISP-bound traffic. Contrary to the view

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use charge) would ensure appropriate cost recovery. *See* Sprint Remand Comments at 2-4. We seek comment on this approach in the *NPRM*.

[143] *See infra* note 158.

[144] We note that many CLECs expressed the same view following adoption of the *Declaratory Ruling* in 1999, yet the problems persist. *See, e.g.*, Cox Reply Comments at 6 (If termination "rates are too high, this is entirely at the ILEC's behest, and should be remedied in the next round of negotiations.").

[145] A number of questions must be resolved before we are prepared to implement fully a bill and keep regime where most costs are recovered from end-users. (We say most, not all, costs are recovered from end-users because a bill and keep regime may include intercarrier charges for transport between networks.) These questions include, for example, the allocation of transport costs between interconnecting carriers and the effect on retail prices of adopting a bill and keep regime that is not limited to ISP-bound traffic. We seek comment on these and other issues in the accompanying intercarrier *NPRM*.

espoused by CLECs, we are concerned that the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to "get the rate right." A few examples may illustrate the vexing problems regulators face. Reciprocal compensation rates have been determined on the basis of the ILEC's average costs of transport and termination. These rates do not, therefore, reflect the costs incurred by any particular carrier for providing service to a particular customer. This encourages carriers to target customers that are, on average, less costly to serve, and reap a reciprocal compensation windfall. Conversely, new entrants lack incentive to serve customers that are, on average, more costly to serve, even if the new entrant is the most efficient provider. It is not evident that this problem can be remedied by setting reciprocal compensation rates on the basis of the costs of carrier serving the called party (or, in the case of ISP-bound traffic, the CLEC that serves the ISP).[146] Apart from our reluctance to require new entrants to perform cost studies, it is entirely impracticable, if not impossible, for regulators to set different intercarrier compensation rates for each individual carrier, and those rates still might fail to reflect a carrier's costs as, for example, the nature of its customer base evolves. Furthermore, most states have adopted per minute reciprocal compensation rate structures. It is unlikely that any minute-of-use rate that is based on average costs and depends upon demand projections will reflect the costs of any given carrier to serve any particular customer. To the extent that transport and termination costs are capacity-driven, moreover, virtually any minute-of-use rate will overestimate the cost of handling an additional call whenever a carrier

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[146] *Cf.* Verizon Remand Reply Comments at 14-15.

is operating below peak capacity.[147] Regulators and carriers have long struggled with problems associated with peak-load pricing.[148] Finally, and most important, the fundamental problem with application of reciprocal compensation to ISP-bound traffic is that the intercarrier payments fail altogether to account for a carrier's opportunity to recover costs from its ISP customers. Modifications to intercarrier rate levels or rate structures suggested by CLECs do not address carriers' ability to shift costs from their own customers onto other carriers and their customers.

2. Intercarrier Compensation for ISP-bound Traffic

77. We believe that a hybrid mechanism that establishes relatively low per minute rates, with a cap on the total volume of traffic entitled to such compensation, is the most appropriate interim approach over the near term to resolve the problems associated with the current intercarrier compensation regime for ISP-bound traffic. Our primary goal at this time is to address the market distortions under the current intercarrier compensation regimes for ISP-bound traffic. At the same time, we believe it prudent to avoid a "flash cut" to a new compensation regime that would upset the legitimate business expectations of carriers and their customers. Subsequent to the Commission's *Declaratory Ruling*, many states have required the payment of reciprocal compensation for ISP-bound traffic, and CLECs may have entered into contracts with vendors or with their ISP

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[147] The problem of putting a per minute price tag, in the form of intercarrier payments, where no per minute cost exists is exacerbated in the case of local exchange carriers that, in most cases, recover costs from their end-users on a flat-rated basis.

[148] *See, e.g., Local Competition Order*, 11 FCC Rcd at 16028-29.

customers that reflect the expectation that the CLECs would continue to receive reciprocal compensation revenue. We believe it appropriate, in tailoring an interim compensation mechanism, to take those expectations into account while simultaneously establishing rates that will produce more accurate price signals and substantially reduce current market distortions. Therefore, pending our consideration of broader intercarrier compensation issues in the *NPRM*, we impose an interim intercarrier compensation regime for ISP-bound traffic that serves to limit, if not end, the opportunity for regulatory arbitrage, while avoiding a market-disruptive "flash cut" to a pure bill and keep regime. The interim regime we establish here will govern intercarrier compensation for ISP-bound traffic until we have resolved the issues raised in the intercarrier compensation *NPRM*.

78. Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. In addition to the rate caps, we will impose a cap on total ISP-bound minutes for which a LEC may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compen-

sation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation under that agreement in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the 2002 ceiling applicable to that agreement.[149]

79. We understand that some carriers are unable to identify ISP-bound traffic. In order to limit disputes and avoid costly efforts to identify this traffic, we adopt a rebuttable presumption that traffic delivered to a carrier, pursuant to a particular contract, that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic that is subject to the compensation mechanism set forth in this Order. Using a rebuttable presumption in this context is consistent with the approach that numerous states have adopted to identify ISP-bound traffic or "convergent" traffic (including ISP traffic) that is subject to a lower reciprocal compensation rate.[150] A carrier may

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[149] This interim regime affects only the intercarrier *compensation* (*i.e.*, the rates) applicable to the delivery of ISP-bound traffic. It does not alter carriers' other obligations under our Part 51 rules, 47 C.F.R. Part 51, or existing interconnection agreements, such as obligations to transport traffic to points of interconnection.

[150] *See* Texas Public Utility Commission, Docket No. 21982, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, at 36 (July 12, 2000) (applying a blended tandem switching rate to traffic up to a 3:1 (terminating to originating) ratio; traffic above that ratio is presumed to be convergent traffic and is compensated at the end office rate unless the terminating carrier can prove tandem functionality); New York Public Service Commission, Op. No. 99-10, Proceeding on Motion of the Commission to Reexamine Reciprocal compensation, Opinion and Order, at 59-60 (Aug. 26, 1999) (traffic above a 3:1 ratio is presumed to be convergent traffic and is compensated at the end

rebut the presumption, for example, by demonstrating to the appropriate state commission that traffic above the 3:1 ratio is in fact local traffic delivered to non-ISP customers. In that case, the state commission will order payment of the state-approved or state-arbitrated reciprocal compensation rates for that traffic. Conversely, if a carrier can demonstrate to the state commission that traffic it delivers to another carrier is ISP-bound traffic, even though it does not exceed the 3:1 ratio, the state commission will relieve the originating carrier of reciprocal compensation payments for that traffic, which is subject instead to the compensation regime set forth in this Order. During the pendency of any such proceedings, LECs remain obligated to pay the presumptive rates (reciprocal compensation rates for traffic below a 3:1 ratio, the rates set forth in this Order for traffic above the ratio), subject to true-up upon the conclusion of state commission proceedings.

80. We acknowledge that carriers incur costs in delivering traffic to ISPs, and it may be that in some instances those costs exceed the rate caps we adopt here. To the extent a LEC's costs of transporting and terminating this traffic exceed the applicable rate caps, however, it may recover those amounts from its own end-users.[151] We

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office rate unless the terminating carrier can demonstrate "that [the terminating] network and service are such as to warrant tandem-rate compensation"); Massachusetts Dept. of Telecommunications and Energy, D.T.E. 97-116-C, at 28-29 n.31 (May 19, 1999) (requiring reciprocal compensation for traffic that does not exceed a 2:1 (terminating to originating) ratio as a proxy to distinguish ISP-bound traffic from voice traffic; carriers may rebut that presumption).

[151] We note that CLEC end-user recovery is generally not regulated. As non-dominant carriers, CLECs can charge their end-users what the market will bear. Access Charge Reform, CC Docket No. 96-262,

also clarify that, because the rates set forth above are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps we adopt here or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic).[152] The rate caps are designed to provide a transition toward bill and keep or such other cost recovery mechanism that the Commission may adopt to minimize uneconomic incentives, and no such transition is necessary for carriers already exchanging traffic at rates below the caps. Moreover, those state commissions have concluded that, at least in their states, LECs receive adequate compensation from their own end-users for the transport and

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Sixth Report and Order, 15 FCC Rcd 12962, 13005 (2000) (*CALLS Order*) ("Competitive LECs are not regulated by the Commission and are not restricted in the same manner as price caps LECs in how they recover their costs."). Accordingly, we permit CLECs to recover any additional costs of serving ISPs from their ISP customers. ILEC end-user charges, however, are generally regulated by the Commission, in the case of interstate charges, or by state commissions, for intrastate charges. Pursuant to the ESP exemption, ILECs will continue to serve their ISP customers out of intrastate business tariffs that are subject to state regulation. As the Commission said in 1997, if ILECs feel that these rates are so low as to preclude cost recovery, they should seek relief from their state commissions. *Access Charge Reform Order*, 12 FCC Rcd at 16134 ("To the extent that some intrastate rate structures fail to compensate incumbent LECs adequately for providing service to customers with *high volumes of incoming calls*, incumbent LECs may address their concerns to state regulators." (emphasis added)).

[152] Thus, if a state has ordered all LECs to exchange ISP-bound traffic on a bill and keep basis, or if a state has ordered bill and keep for ISP-bound traffic in a particular arbitration, those LECs subject to the state order would continue to exchange ISP-bound traffic on a bill and keep basis.

termination of ISP-bound traffic and need not rely on intercarrier compensation.

81. Finally, a different rule applies in the case where carriers are not exchanging traffic pursuant to interconnection agreements prior to adoption of this Order (where, for example, a new carrier enters the market or an existing carrier expands into a market it previously had not served). In such a case, as of the effective date of this Order, carriers shall exchange ISP-bound traffic on a bill-and-keep basis during this interim period. We adopt this rule for several reasons. First, our goal here is to address and curtail a pressing problem that has created opportunities for regulatory arbitrage and distorted the operation of competitive markets. In so doing, we seek to confine these market problems to the maximum extent while seeking an appropriate long-term resolution in the proceeding initiated by the companion *NPRM*. Allowing carriers in the interim to expand into new markets using the very intercarrier compensation mechanisms that have led to the existing problems would exacerbate the market problems we seek to ameliorate. For this reason, we believe that a standstill on any expansion of the old compensation regime into new markets is the more appropriate interim answer.[163] Second, unlike those carriers that are presently serving ISP customers under existing interconnection agreements, carriers entering new markets to serve ISPs have not acted in reliance on reciprocal compensation revenues and thus have no need of a

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[163] *See American Public Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000) ("Where existing methodology or research in a new area of regulation is deficient, the agency necessarily enjoys broad discretion to attempt to formulate a solution to the best of its ability on the basis of available information.").

transition during which to make adjustments to their prior business plans.

82. The interim compensation regime we establish here applies as carriers renegotiate expired or expiring interconnection agreements. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions. This Order does not preempt any state commission decision regarding compensation for ISP-bound traffic for the period prior to the effective date of the interim regime we adopt here. Because we now exercise our authority under section 201 to determine the appropriate intercarrier compensation for ISP-bound traffic, however, state commissions will no longer have authority to address this issue. For this same reason, as of the date this Order is published in the Federal Register, carriers may no longer invoke section 252(i) to opt into an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic.[154] Section 252(i) applies only to agreements arbitrated or approved by state commissions pursuant to section 252; it

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[154] 47 U.S.C. § 252(i) (requiring LECs to "make available any interconnection, service, or network element provided under an agreement approved under this section" to "any other requesting telecommunications carrier"). This Order will become effective 30 days after publication in the Federal Register. We find there is good cause under 5 U.S.C. § 553(d)(3), however, to prohibit carriers from invoking section 252(i) with respect to rates paid for the exchange of ISP-bound traffic upon publication of this Order in the Federal Register, in order to prevent carriers from exercising opt in rights during the thirty days after Federal Register publication. To permit a carrier to opt into a reciprocal compensation rate higher than the caps we impose here during that window would seriously undermine our effort to curtail regulatory arbitrage and to begin a transition from dependence on intercarrier compensation and toward greater reliance on end-user recovery.

has no application in the context of an intercarrier compensation regime set by this Commission pursuant to section 201.[155]

83. This interim regime satisfies the twin goals of compensating LECs for the costs of delivering ISP-bound traffic while limiting regulatory arbitrage. The interim compensation regime, as a whole, begins a transition toward what we have tentatively concluded, in the companion *NPRM*, to be a more rational cost recovery mechanism under which LECs recover more of their costs from their own customers. This compensation mechanism is fully consistent with the manner in which the Commission has directed incumbent LECs to recover the costs of serving ESPs, including ISPs.[156] The three-year transition we adopt here ensures that carriers have sufficient time to re-order their business plans and customer relationships, should they so choose, in light of our tentative conclusions in the companion *NPRM* that bill and keep is the appropriate long-term intercarrier compensation regime. It also affords the Commission adequate time to consider comprehensive reform of all intercarrier compensation regimes in the *NPRM* and any resulting rulemaking proceedings. Both the rate caps and the volume limitations reflect our view that LECs should begin to formulate business plans that reflect

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[155] In any event, our rule implementing section 252(i) requires incumbent LECs to make available "[i]ndividual interconnection, service, or network element arrangements" to requesting telecommunications carriers only "for a reasonable period of time." 47 C.F.R. § 51.809(c). We conclude that any "reasonable period of time" for making available rates applicable to the exchange of ISP-bound traffic expires upon the Commission's adoption in this Order of an intercarrier compensation mechanism for ISP-bound traffic.

[156] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34.

decreased reliance on revenues from intercarrier compensation, given the trend toward substantially lower rates and the strong possibility that the *NPRM* may result in the adoption of a full bill and keep regime for ISP-bound traffic.

84. We acknowledge that there is no exact science to setting rate caps to limit carriers' ability to draw revenue from other carriers, rather than from their own end-users. Our adoption of the caps here is based on a number of considerations. First, rates that produce meaningful reductions in intercarrier payments for ISP-bound traffic must be at least as low as rates in existing interconnection agreements. Second, although we make no finding here regarding the actual costs incurred in the delivery of ISP-bound traffic, there is evidence in the record to suggest that technological developments are reducing the costs incurred by carriers in handling all sorts of traffic, including ISP-bound traffic.[157] Third, although the process has proceeded too slowly to address the market distortions discussed above, we note that negotiated reciprocal compensation rates continue to decline as ILECs and CLECs negotiate new interconnection agreements. Finally, CLECs have been on notice since the 1999 *Declaratory Ruling* that it might be

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[157] *See, e.g.*, Letter from David J. Hostetter, SBC, to Magalie Roman Salas, Secretary, FCC (Feb. 14, 2001), Attachment (citing September 2000 Morgan Stanley Dean Witter report that discusses utilization of lower cost switch technology); Donny Jackson, "One Giant Leap for Telecom Kind?," *Telephony*, Feb. 12, 2001, at 38 (discussing cost savings associated with replacing circuit switches with packet switches); Letter from Gary L. Phillips, SBC, to Magalie Roman Salas, Secretary, FCC (Feb. 16, 2001) (attaching press release from Focal Communications announcing planned deployment of next-generation switching technology "at a fraction of the cost of traditional equipment"); *see also infra* para. 93.

unwise to rely on the continued receipt of reciprocal compensation for ISP-bound traffic, thus many have begun the process of weaning themselves from these revenues.

85. The rate caps adopted herein reflect all these considerations. The caps we have selected approximate the downward trend in intercarrier compensation rates reflected in recently negotiated interconnection agreements. In these agreements, carriers have agreed to rates, like those we adopt here, that decline each year of a three-year contract term, and at least one agreement reflects different rates for balanced and unbalanced traffic.[158] For example, the initial rate cap of $.0015/mou

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[158] The Commission takes notice of the following interconnection agreements: (1) Level 3 Communications and SBC Communications (effective through May 2003): This 13-state agreement has two sets of rates. For balanced traffic, the rate is $.0032/mou. For traffic that is out of balance by a ratio exceeding 3:1, the rate starts at $.0018/mou, declining to a weighted average rate of $.0007/mou by June 1, 2002. *See* PR Newswire, WL PRWIRE 07:00:00 (Jan. 17, 2001); Letter from John T. Nakahata, Harris, Wiltshire & Grannis, to Magalie Roman Salas, Secretary, FCC, Attachment (Jan. 19, 2001). (2) ICG Communications and BellSouth (retroactively effective to Jan. 1, 2000): This agreement provides for rates to decline over three years, from $0.002/mou to $0.00175/mou to $0.0015/mou. *See* Communications Daily, 2000 WL 4694709 (Mar. 15, 2000). (3) KMC Telecom and BellSouth: This agreement provides for a rate of $0.002/mou in 2000, $0.00175/mou in 2001, $0.0015/mou in 2002. *See* Business Wire, WL 5/18/00 BWIRE 12:50:000 (May 18, 2000). (4) Level 3 Communications and Verizon (formerly Bell Atlantic) (effective Oct. 14, 1999): This agreement governs all of the former Bell Atlantic/NYNEX states. The applicable rate declines over the term of the agreement from $.003/mou in 1999 to rates in 2001 of $.0015/mou for balanced traffic and $.0012/mou where the traffic imbalance exceeds a 10:1 ratio. *See* Letter from Joseph J. Mulieri, Bell Atlantic, to Magalie Roman Salas, Secretary, FCC (Nov. 22, 1999) (attaching agreement); *see also* Letter from John T.

approximates the rates applicable this year in agreements Level 3 has negotiated with Verizon and SBC.[159] The $.0010/mou rate that applies during most of the three-year interim period reflects a proposal by ALTS, the trade association representing CLECs, for a transition plan pursuant to which intercarrier compensation payments for ISP-bound traffic would decline to $.0010/mou.[160] Similarly, the $.0007/mou rate reflects the average rate applicable in 2002 under Level 3's agreement with SBC.[161] We conclude, therefore, that the rate caps constitute a reasonable transition toward the recovery of costs from end-users.

86. We impose an overall cap on ISP-bound minutes for which compensation is due in order to ensure that growth in dial-up Internet access does not undermine our efforts to limit intercarrier compensation for this traffic and to begin, subject to the conclusion of the *NPRM* proceedings, a smooth transition toward a bill and keep regime. A ten percent growth cap, for the first two years, seems reasonable in light of CLEC projections that the growth of dial-up Internet minutes will fall in the range

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Nakahata, Harris, Wiltshire & Grannis, to Magalie Roman Salas, Secretary, FCC, at 2 (Jan. 4, 2001) (reciprocal compensation rate in most recent Level 3—Verizon agreement is now $.0012/mou in all states except New York, where the rate is $.0015/mou).

[159] In the Level 3—SBC agreement, the applicable rate is $.0018/mou for traffic that exceeds a 3:1 ratio; in the Level 3—Verizon agreement, the applicable rate is $.0015/mou for balanced traffic and $.0012/mou for traffic that exceeds a 10:1 ratio. *See supra* note 158.

[160] *See* Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC, at 3 (Dec. 19, 2000).

[161] *See supra* note 158.

of seven to ten percent per year.[162] We are unpersuaded by the ILECs' projections that dial-up minutes will grow in the range of forty percent per year,[163] but adoption of a cap on growth largely moots this debate. If CLECs have projected growth in the range of ten percent, then limiting intercarrier compensation at that level should not disrupt their customer relationships or their business planning. Nothing in this Order prevents any carrier from serving or indeed expanding service to ISPs, so long as they recover the costs of additional minutes from their ISP customers. The caps merely ensure that growth in minutes above the caps is based on a given carrier's ability to provide efficient and quality service to ISPs, rather than on a carrier's desire to reap an intercarrier compensation windfall.

87. We are not persuaded by arguments proffered by CLECs that requiring them to recover more of their costs from their ISP customers will render it impossible for CLECs profitably to serve ISPs or will lead to higher

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[162] *See, e.g.*, Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC (Dec. 18, 2000) (offering evidence that dial-up traffic per household will grow only 7%/year from 1998 to 2003 and that dial-up household penetration will decline between 2000 and 2003); Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC (Jan. 9, 2001) (citing, *inter alia*, Merrill Lynch estimate of 7% annual increased Internet usage per user between 1999 and 2003, and PricewaterhouseCoopers' study suggesting that Internet usage per user declined from 1999 to 2000).

[163] *See, e.g.*, Letter from Robert T. Blau, BellSouth, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Dec. 22, 2000) (forecasting 42% annual growth in total Internet access minutes between 2000 and 2003); *but see* Dan Beyers, "Internet Use Slipped Late Last Year," Washingtonpost.com, Feb. 22, 2001, at E10 (noting decline in average time spent online in 2000).

rates for Internet access.[164] First, as noted above, this compensation mechanism is fully consistent with the manner in which this Commission has directed ILECs to recover the costs of serving ISPs.[165] Moreover, the evidence in the record does not demonstrate that CLECs cannot compete for ISP customers in the growing number of states that have adopted bill and keep for ISP-bound traffic or that the cost of Internet access has increased in those states. Second, next-generation switching and other technological developments appear to be contributing to a decline in the costs of serving ISPs (and other customers).[166] Third, if reciprocal compensation merely enabled CLECs to recover the costs of serving ISPs, CLECs should be indifferent between serving ISPs and other customers. Instead, CLECs have not contradicted ILEC assertions that more than ninety percent of CLEC reciprocal compensation billings are for ISP-bound traffic,[167] suggesting that there may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination.[168] Finally, there is reason to believe that our failure

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[164] *See, e.g.*, Time Warner Remand Comments at 4-5; Centennial Remand Comments at 2, 6-7.

[165] *Access Charge Reform Order*, 12 FCC Rcd at 16134; *MTS/WATS Market Structure Order*, 97 FCC 2d at 720-721.

[166] *See infra* para. 93.

[167] *See* Letter from Robert T. Blau, BellSouth, *et al.*, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 4 (Nov. 3, 2000); SBC Remand Comments at 42, 51, 57.

[168] We do not suggest that it costs CLECs less to serve ISPs than other types of customers. New switching technologies make it less costly to serve *all* customers. If, however, costs are lower than prevailing reciprocal compensation rates, then CLECs are likely to target customers, such as ISPs, with predominantly incoming traffic, in order to maximize the resulting profit.

to act, rather than the actions we take here, would lead to higher rates for Internet access, as ILECs seek to recover their reciprocal compensation liability, which they incur on a minute-of-use basis, from their customers who call ISPs.[169] Alternatively, ILECs might recover these costs from all of their local customers, including those who do not call ISPs.[170] There is no public policy rationale to support a subsidy running from all users of basic telephone service to those end-users who employ dial-up Internet access.[171]

88. We also are not convinced by the claim of CLECs that limiting intercarrier compensation for ISP-bound traffic will result in a windfall for the incumbent LECs.[172] The CLECs argue that the incumbents' local rates are set to recover the costs of originating and terminating calls and that the ILECs avoid termination costs when their end-users call ISP customers served by CLECs. The record does not establish that ILECs necessarily

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[169] *See, e.g.*, Verizon Remand Comments at 16.

[170] *Id.*

[171] Most CLECs assert that they compete with ILECs on service, not price, and that the rates they charge to ISPs are comparable to the ILEC rates for the same services. *See, e.g.*, Time Warner Remand Comments at 5. We acknowledge, however, that any CLECs that use reciprocal compensation payments to offer below cost service to ISPs may be unable to continue that practice under the compensation regime we adopt here. We reiterate that we see no public policy reason to maintain a subsidy running from ILEC end-users to ISPs and their customers.

[172] *See, e.g.*, Letter from Robert W. McCausland, Allegiance Telecom; Kelsi Reeves, Time Warner Telecom; Richard J. Metzger, Focal, R. Gerard Salemme, XO Communications; and Heather B. Gold, Intermedia; to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 6 (Oct. 20, 2000).

avoid costs when they deliver calls to CLECs,[173] and CLECs have not demonstrated that ILEC end-user rates are designed to recover from the originating end-user the costs of delivering calls to ISPs. The ILECs point out that, in response to their complaints about the costs associated with delivering traffic to ISPs, the Commission has directed them to seek permission from state regulators to raise the rates they charge *the ISPs*, an implicit acknowledgement that ILECs may not recover all of their costs from the originating end-user.[174]

3. Relationship to Section 251(b)(5)

89. It would be unwise as a policy matter, and patently unfair, to allow incumbent LECs to benefit from reduced intercarrier compensation rates for ISP-bound traffic, with respect to which they are net payors,[175] while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher than the caps

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[173] *See, e.g.*, SBC Remand Reply Comments at 31-32 (explaining how an ILEC may incur additional switching and transport costs when its end-user customer calls an ISP served by a CLEC).

[174] *See Access Charge Reform Order*, 12 FCC Rcd at 16134; *see also MTS/WATS Market Structure Order*, 97 FCC 2d at 721 (the local business line rate paid by ISPs subsumes switching costs). Moreover, most states have adopted price cap regulation of local rates, in which case rates do not necessarily correlate to cost in the manner the CLECs suggest. *See* "Price Caps Standard Form of Telco Regulation in 70% of States," Communications Daily, 1999 WL 7580319 (Sept. 8, 1999).

[175] The four largest incumbent LECs—SBC, BellSouth, Verizon, and Qwest—estimate that they owed over $2 billion in reciprocal compensation for ISP-bound traffic in 2000. *See, e.g.*, Letter from Robert T. Blau, BellSouth, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Jan. 16, 2001).

we adopt here, when the traffic imbalance is reversed.[176] Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to "pick and choose" intercarrier compensation regimes, depending on the nature of the traffic exchanged with another carrier. The rate caps for ISP-bound traffic that we adopt here apply, therefore, *only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5)[177] at the same rate. Thus, if the applicable rate cap is $.0010/mou, the ILEC must offer to exchange section 251(b)(5) traffic at that same rate. Similarly, if an ILEC wishes to continue to exchange ISP-bound traffic on a bill and keep basis in a state that has ordered bill and keep, it must offer to exchange all section 251(b)(5) traffic on a bill and keep basis.[178] For those incumbent

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[176] More calls are made from wireless phones to wireline phones than vice-versa. The ILECs, therefore, are net recipients of reciprocal compensation from wireless carriers.

[177] Pursuant to the analysis we adopt above, section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier other than a CMRS provider that is not interstate or intrastate access traffic delivered to an IXC or an information service provider, and to telecommunications traffic between a LEC and a CMRS provider that originates and terminates within the same MTA. *See supra* § IV.B.

[178] If, however, a state has ordered bill and keep for ISP-bound traffic only with respect to a particular interconnection agreement, as opposed to state-wide, we do not require the incumbent LEC to offer to exchange all section 251(b)(5) traffic on a bill and keep basis. This limitation is necessary so that an incumbent is not required to deliver all section 251(b)(5) in a state on a bill and keep basis even though it continues to pay compensation for most ISP-bound traffic in that state. *See, e.g.*, Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC (April 2, 2001) (citing, for example, Washington state, where 16% of ISP-bound traffic is subject to bill and keep). In those states, the rate caps we adopt here will apply to ISP-bound traffic that is not subject to bill and keep under the

LECs that choose *not* to offer to exchange section 251(b)(5) traffic subject to the same rate caps we adopt for ISP-bound traffic, we order them to exchange ISP-bound traffic at the state-approved or state-arbitrated reciprocal compensation rates reflected in their contracts.[179] This "mirroring" rule ensures that incumbent LECs will pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

90. This is the correct policy result because we see no reason to impose different rates for ISP-bound and voice traffic. The record developed in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP.[180] Assuming the two

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particular interconnection agreement if the incumbent LEC offers to exchange all section 251(b)(5) traffic subject to those rate caps.

[179] ILECs may make this election on a state-by-state basis.

[180] Many commenters argue that there is, in fact, no difference between the cost and network functions involved in terminating ISP-bound calls and the cost and functions involved in terminating other calls to users of the public switched telephone network. *See, e.g.*, AOL Comments at 10-12 ("there is absolutely no technical distinction, and therefore no cost differences, between the way an incumbent LEC network handles ISP-destined traffic and the way it handles other traffic within the reciprocal compensation framework."); AT&T Comments at 10-11 ("[T]here is no economic justification for subjecting voice and data traffic to different compensation rules." "ILECs have not demonstrated, and cannot demonstrate, that the costs of transporting and terminating data traffic differ categorically from the costs of transporting and terminating ordinary voice traffic."); Choice One Comments at 8 ("[C]osts do not vary significantly based on whether data or voice traffic is being transmitted."); Corecomm Reply at 2 (network functions are identical whether a carrier is providing service to an ISP or any other end-user); Cox Comments at 7 & Exhibit 2, Statement of Gerald W. Brock at 2 ("None of the distinctions between ISP calls and average calls relate to a cost

calls have otherwise identical characteristics (*e.g.*, duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP.[181] We therefore are unwilling to take any action that results in the establishment of separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.[182] To the extent that the record indicates that per minute reciprocal compensation rate levels and rate structures produce inefficient results, we conclude that the problems lie with this recovery mechanism in general and are not limited to any particular type of traffic.

91. We are not persuaded by commenters' claims that the rates for delivery of ISP-bound traffic and local voice traffic should differ because delivering a data call to an ISP is inherently less costly than delivering a voice call to a local end-user. In an attached declaration to Verizon's comments, William Taylor argues that reciprocal compensation rates may reflect switching costs associated

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difference for handling the calls."); MediaOne Comments at 4 (LECs incur the same costs for terminating calls to an ISP as they do for terminating any other local calls); Time Warner Comments at 9 ("[A]ll LECs perform the same functions when transporting and delivering calls to ISP end-users as they do when transporting and delivering calls to other end-users. When LECs perform the same functions, they incur the same costs."); Letter from Donald F. Shepheard, Time Warner Telecom, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Feb. 28, 2001) (disputing claim that CLEC switching costs are as low as the ILECs argue).

[181] *See, e.g.*, Cox Comments at Exhibit 2, Statement of Gerald W. Brock at 2.

[182] *See, e.g.*, Intermedia Comments at 3-4 (arguing that the rates for transport and termination of ISP-bound traffic must be identical to the rates established for the transport and termination of local traffic).

with both originating and terminating functions, despite the fact that ISP traffic generally flows in only one direction.[183] If correct, however, this observation suggests a need to develop rates or rate structures for the transport and termination of *all* traffic that exclude costs associated solely with originating switching.[184] Mr. Taylor similarly argues that ISP-bound calls generally are longer in duration than voice calls, and that a per-minute rate structure applied to calls of longer duration will spread the fixed costs of these calls over more minutes, resulting in lower per-minute costs, and possible over recovery of the fixed costs incurred.[185] Any possibility of over recovery associated with calls (to ISPs or otherwise) of longer than average duration can be eliminated through adoption of rate structures that provide for recovery of per-call costs on a per-call basis, and minute-of-use costs on a minute-of-use basis.[186] We also are not convinced that ISP-bound calls have a lower load distribution (*i.e.*, number and duration of calls in the busy hour as a percent of total traffic), and that these calls therefore impose lower additional costs on a network.[187] It is not clear from

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[183] *See* Verizon Remand Comments, Declaration of William E. Taylor at 14, 17.

[184] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 14. *See also* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC, Attachment at 7-8 (Oct. 26, 2000).

[185] *See* Verizon Remand Comments, Declaration of William E. Taylor at 14-15.

[186] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 10-11. Time Warner also disputes that the "average duration of calls to ISPs has been accurately measured to date." *Id.* at 11.

[187] *See* Verizon Remand Comments, Declaration of William E. Taylor at 17-18.

the record that there is any "basis to speculate that the busy hour for calls to ISPs will be different than the CLEC switch busy hour,"[188] especially when the busy hour is determined by the flow of both voice and data traffic.

92. Nor does the record demonstrate that CLECs and ILECs incur different costs in delivering traffic that would justify disparate treatment of ISP-bound traffic and local voice traffic under section 251(b)(5). Ameritech maintains that it costs CLECs less to deliver ISP-bound traffic than it costs incumbent LECs to deliver local traffic because CLECs can reduce transmission costs by locating their switches close to ISPs.[189] The proximity of the ISP or other end-user to the delivering carrier's switch, however, is irrelevant to reciprocal compensation rates.[190] The Commission concluded in the *Local Competition Order* that the non-traffic sensitive cost of the local loop is not an "additional" cost of terminating traffic that a LEC is entitled to recover through reciprocal compensation.[191]

93. SBC argues that CLECs should not be entitled to symmetrical reciprocal compensation rates for the deliv-

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[188] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 14-15.

[189] *See* Letter from Gary L. Phillips, Ameritech, to Magalie Roman Salas, Secretary, FCC, Attachment at 5 (Sept. 14, 1999). *See also* SBC Remand Comments at 32-33 (referring to Global NAPS Comments, Exhibit 1, Statement of Fred Goldstein at 6, which describes CLEC reduction of loop costs through collocation); Letter from Melissa Newman, U S West, to Magalie Roman Salas, Secretary, FCC, Attachment at 8 (Dec. 2, 1999).

[190] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 25.

[191] *See Local Competition Order*, 11 FCC Rcd at 16025.

ery of ISP-bound traffic, because CLECs do not provide end office switching functionality to their ISP customers and therefore do not incur the same costs that ILECs incur when delivering local voice traffic. Specifically, SBC claims that the switching functionality that CLECs provide to ISPs is more like a trunk-to-trunk connection than the switching functionality normally provided at end offices.[192] SBC also claims that CLECs are able to reduce the costs of delivering ISP-bound traffic by using new, less expensive switches that do not perform the functions necessary for both the origination and delivery of two-way voice traffic.[193] Similarly, GTE asserts that new technologies and system architectures make it possible for some CLECs to reduce costs by entirely avoiding circuit-switching on calls "to selected telephone numbers."[194] CLECs respond, however, that they are in fact using the same circuit switching technology used by ILECs to terminate the vast portion of Internet traffic.[196] In any

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[192] SBC Remand Comments at 33.

[193] SBC Remand Comments at 33-34 (referring, *inter alia*, to "managed modem" switches).

[194] GTE Comments at 7-8 (noting the existence of SS7 bypass devices that can avoid circuit switching and arguing that competitive LEC networks are far less complex and utilize fewer switches than incumbent LEC networks); GTE Reply Comments at 16 (compensating competitive LECs based on an incumbent LEC's costs inflates the revenue that competitive LECs receive); Letter from W. Scott Randolph, GTE, to Magalie Roman Salas, Secretary, FCC, Attachment (Dec. 8, 1999 (new generation traffic architectures may use SS7 Gateways instead of more expensive circuit-switched technology).

[195] *See, e.g.*, Letter from John D. Windhausen, Jr., ALTS, and H. Russell Frisby, Jr., CompTel, to Kyle Dixon, Legal Advisor, Chairman Michael Powell, FCC, at 4-5 (March 16, 2001) (Focal is testing two softswitches, but as of now all ISP-bound traffic terminated by Focal uses traditional circuit switches; Allegiance Telecom has a

event, it is not evident from any of the comments in the record that the apparent efficiencies associated with new system architectures apply exclusively to data traffic, and not to voice traffic as well. ILECs and CLECs alike are free to deploy new technologies that provide more efficient solutions to the delivery of certain types of traffic,[196] and these more efficient technologies will, over time, be reflected in cost-based reciprocal compensation rates. The overall record in this proceeding does not lead us to conclude that any system architectures or technologies widely used by LECs result in material differences between the cost of delivering ISP-bound traffic and the cost of delivering local voice traffic, and we see no reason,

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single softswitch in its network; Advanced Telecom Group, Inc. is in the testing phase of softswitch deployment; Pac-West Telecomm, Inc., does not have any softswitches in its network; e.spire uses only circuit switches to terminate ISP-bound traffic); Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 27 (Time Warner is "deploying fully functional end office switches"); Letter from Donald F. Shepheard, Time Warner, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 3 (February 28, 2001) (Time Warner "does not provide managed modem services." Like the ILECs, Time Warner "has an extensive network of circuit switched technology" and has only just begun to deploy softswitches); Letter from Teresa Marrero, AT&T, to Magalie Roman Salas, Secretary, FCC, at 1 (April 11, 2001) ("Virtually all of AT&T's ISP-bound traffic is today terminated using full circuit switches.").

[196] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 28; *see also* Letter from Donald F. Shepheard, Time Warner, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 3 (Feb. 28, 2001) ("if softswitch technology will lower carriers' costs, then all carriers, including the ILECs [,] will have incentive to deploy them"); Letter from John D. Windhausen, Jr., ALTS, and H. Russell Frisby, Jr., CompTel, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 4 (February 16, 2001) (same).

therefore, to distinguish between voice and ISP traffic with respect to intercarrier compensation.

94. Some CLECs take this argument one step further. Whatever the merits of bill and keep or other reforms to intercarrier compensation, they say, any such reform should be undertaken only in the context of a comprehensive review of *all* intercarrier compensation regimes, including the interstate access charge regime.[197] First, we reject the notion that it is inappropriate to remedy some troubling aspects of intercarrier compensation until we are ready to solve all such problems. In the most recent of our access charge reform orders, we recognized that it is "preferable and more reasonable to take several steps in the right direction, even if incomplete, than to remain frozen" pending "a perfect, ultimate solution."[198] Moreover, it may make sense to begin reform by rationalizing intercarrier compensation between competing providers of telecommunications services, to encourage efficient entry and the development of robust competition, rather than waiting to complete reform of the interstate access charge regime that applies to incumbent LECs, which was created in a monopoly environment for quite different purposes. Second, the interim compensation scheme we adopt here is fully consistent with the course the Commission has pursued with respect to access charge reform. A primary feature of the *CALLS Order* is the phased elimination of the PICC and CCL,[199] two intercarrier payments we found to be

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[197] *See, e.g.*, Letter from Karen L. Gulick, Harris, Wiltshire & Grannis, to Magalie Roman Salas, Secretary, FCC, at 1 (Dec. 22, 2000).

[198] *See CALLS Order*, 15 FCC Rcd at 12974.

[199] The PICC, or presubscribed interexchange carrier charge, and the CCLC, carrier common line charge, are charges levied by incum-

inefficient, in favor of greater recovery from end-users through an increased SLC, an end-user charge.[200] Finally, like the *CALLS Order*, the interim regime we adopt here "provides relative certainty in the marketplace" pending further Commission action, thereby allowing carriers to develop business plans, attract capital, and make intelligent investments.[201]

D. Conclusion

95. In this Order, we strive to balance the need to rationalize an intercarrier compensation scheme that has hindered the development of efficient competition in the local exchange and exchange access markets with the need to provide a fair and reasonable transition for CLECs that have come to depend on intercarrier compensation revenues. We believe that the interim compensation regime we adopt herein responds to both concerns. The regime should reduce carriers' reliance on carrier-to-carrier payments as they recover more of their costs from end-users, while avoiding a "flash cut" to bill and keep which might upset legitimate business expectations. The interim regime also provides certainty to the industry during the time that the Commission considers broader reform of intercarrier compensation mechanisms in the *NPRM* proceeding. Finally, we hope this Order

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bent LECs upon IXCs to recover portions of the interstate-allocated cost of subscriber loops. *See* 47 C.F.R. §§ 69.153, 69.154.

[200] *CALLS Order*, 15 FCC Rcd at 12975 (permitting a greater proportion of the local loop costs of primary residential and single-line business customers to be recovered through the SLC).

[201] *CALLS Order*, 15 FCC Rcd at 12977 (The CALLS proposal is aimed to "bring lower rates and less confusion to consumers; and create a more rational interstate rate structure. This, in turn, will support more efficient competition, more certainty for the industry, and permit more rational investment decisions.").

brings an end to the legal confusion resulting from the Commission's historical treatment of ISP-bound traffic, for purposes of jurisdiction and compensation, and the statutory obligations and classifications adopted by Congress in 1996 to promote the development of competition for all telecommunications services. We believe the analysis set forth above amply responds to the court's mandate that we explain how our conclusions regarding ISP-bound traffic fit within the governing statute.[202]

V. PROCEDURAL MATTERS

A. Final Regulatory Flexibility Analysis

96. As required by the Regulatory Flexibility Act (RFA),[203] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *Declaratory Ruling and NPRM*.[204] The Commission sought and received written comments on the IRFA. The Final Regulatory Flexibility Analysis (FRFA) in this Order on Remand and Report and Order conforms to the RFA, as amended.[205] To the extent that any statement contained in this FRFA is perceived as creating ambiguity with respect to our rules, or statements made in preceding sections of this Order on Remand and Report and Order, the rules and statements set forth in those preceding sections shall be controlling.

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[202] *Bell Atlantic*, 206 F.3d at 8.

[203] *See* 5 U.S.C. § 603.

[204] *Declaratory Ruling*, 14 FCC Rcd at 3710-13.

[205] *See* 5 U.S.C. § 604. The Regulatory Flexibility Act, 5 U.S.C. § 601 *et. seq.*, was amended by the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA), which was enacted as Title II of the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA).

1. Need for, and Objectives of, this Order on Remand and Report and Order

97. In the *Declaratory Ruling*, we found that we did not have an adequate record upon which to adopt a rule regarding intercarrier compensation for ISP-bound traffic, but we indicated that adoption of a rule would serve the public interest.[256] We sought comment on two alternative proposals, and stated that we might issue new rules or alter existing rules in light of the comments received.[257] Prior to the release of a decision, the Court of Appeals for the District of Columbia Circuit vacated certain provisions of the *Declaratory Ruling* and remanded the matter to the Commission.[258]

98. This Order on Remand and Report and Order addresses the concerns of various parties to this proceeding and responds to the court's remand. The Commission exercises jurisdiction over ISP-bound traffic pursuant to section 201, and establishes a three-year interim intercarrier compensation mechanism for the exchange of ISP-bound traffic that applies if incumbent LECs offer to exchange section 251(b)(5) traffic at the same rates. During this interim period, intercarrier compensation for ISP-bound traffic is subject to a rate cap that declines over the three-year period, from $.0015/mou to $.0007/mou. The Commission also imposes a cap on the total ISP-bound minutes for which a LEC may receive this compensation under a particular interconnection agreement equal to, on an annualized basis, the number

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[256] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3707.

[257] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[258] *See Bell Atlantic*, 206 F.3d 1.

of ISP-bound minutes for which that LEC was entitled to receive compensation during the first quarter of 2001, increased by ten percent in each of the first two years of the transition. If an incumbent LEC does not offer to exchange all section 251(b)(5) traffic subject to the rate caps set forth herein, the exchange of ISP-bound traffic will be governed by the reciprocal compensation rates approved or arbitrated by state commissions.

2. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

99. The Office of Advocacy, U.S. Small Business Administration (Office of Advocacy) submitted two filings in response to the IRFA.[208] In these filings, the Office of Advocacy raises significant issues regarding our description, in the IRFA, of small entities to which our rules will apply, and the discussion of significant alternatives considered and rejected. Specifically, the Office of Advocacy argues that the Commission has failed accurately to identify all small entities affected by the rulemaking by refusing to characterize small incumbent local exchange carriers (LECs), and failing to identify small ISPs, as small entities.[209] We note that, in the IRFA, we stated that we excluded small incumbent LECs from the definitions of "small entity" and "small business concern" because such companies are either dominant in their field of operations or are not independently owned and oper-

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[208] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999.

[209] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999, at 1-3; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 2-3.

ated.[211] We also stated, however, that we would nonetheless, out of an abundance of caution, include small incumbent LECs in the IRFA, and did so.[212] Small incumbent LECs and other relevant small entities are included in our present analysis as described below.

100. The Office of Advocacy also states that Internet service providers (ISPs) are directly affected by our actions, and therefore should be included in our regulatory flexibility analysis. We find, however, that rates charged to ISPs are only indirectly affected by our actions. We have, nonetheless, briefly discussed the effect on ISPs in the primary text of this Order.[213]

101. Last, the Office of Advocacy also argues that the Commission has failed to adequately address significant alternatives that accomplish our stated objective and minimize any significant economic impact on small entities.[214] We note that, in the IRFA, we described the nature and effect of our proposed actions, and encouraged small entities to comment (including giving comment on possible alternatives). We also specifically sought comment on the two alternative proposals for implementing intercarrier compensation—one that resolved intercarrier compensation pursuant to the negotiation and arbitration process set forth in Section 252, and another that would have had us adopt a set of federal rules to

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[211] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[212] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[213] *See supra* paras. 87-88.

[214] Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 3.

govern such intercarrier compensation.[215] We believe, therefore, that small entities had a sufficient opportunity to comment on alternative proposals.

102. NTCA also filed comments, not directly in response to the IRFA, urging the Commission to fulfill its obligation to consider small telephone companies.[216] Some commenters also raised the issue of small entity concerns over increasing Internet traffic and the use of Extended Area Service (EAS) arrangements.[217] We are especially sensitive to the needs of rural and small LECs that handle ISP-bound traffic, but we find that the costs that LECs incur in *originating* this traffic extends beyond the scope of the present proceeding and should not dictate the appropriate approach to compensation for *delivery* of ISP-bound traffic.

3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply

103. The rules we are adopting apply to local exchange carriers. To estimate the number of small entities that would be affected by this economic impact, we first consider the statutory definition of "small entity" under the RFA. The RFA generally defines "small entity" as having the same meaning as the term "small business," "small organization," and "small governmental jurisdiction."[218] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act, unless the Commission

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[215] *Declaratory Ruling [IRFA]*, 14 FCC Rcd at 3711 (para. 39); *see also Declaratory Ruling*, 14 FCC Rcd at 3707-08 (paras. 30-31).

[216] NTCA Comments at vi, 15.

[217] *See, e.g.*, ICORE Comments at 1-7; IURC Comments at 7; Richmond Telephone Company Comments at 1-8.

[218] 5 U.S.C. § 601(6).

has developed one or more definitions that are appropriate to its activities.[219] Under the Small Business Act, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.[220] The SBA has defined a small business for Standard Industrial Classification (SIC) categories 4812 (Radiotelephone Communications) and 4813 (Telephone Communications, Except Radiotelephone) to be small entities when they have no more than 1,500 employees.[221]

104. The most reliable source of information regarding the total numbers of certain common carrier and related providers nationwide, as well as the numbers of commercial wireless entities, appears to be data the Commission publishes annually in its Carrier Locator report, derived from filings made in connection with the Telecommunications Relay Service (TRS).[222] According to data in the most recent report, there are 4,144 interstate carriers.[223] These carriers include, *inter alia*, incumbent local exchange carriers, competitive local exchange carriers, competitive access providers, interexchange carriers, other wireline carriers and service providers (including shared-tenant service providers and private carriers), operator service providers, pay telephone

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[219] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632).

[220] 15 U.S.C. § 632.

[221] 13 C.F.R. § 121.201.

[222] FCC, Carrier Locator: Interstate Service Providers, Figure 1 (Jan. 2000) (*Carrier Locator*).

[223] *Carrier Locator* at Fig. 1.

operators, providers of telephone toll service, wireless carriers and services providers, and resellers.

105. We have included small incumbent local exchange carriers (LECs) in this regulatory flexibility analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g.*, a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[224] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not "national" in scope.[225] We have therefore included small incumbent LECs in this regulatory flexibility analysis, although we emphasize that this action has no effect on the Commission's analyses and determinations in other, non-RFA contexts.

106. Total Number of Telephone Companies Affected. The United States Bureau of the Census (the Census Bureau) reports that, at the end of 1992, there were 3,497 firms engaged in providing telephone ser-

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[224] 5 U.S.C. § 601(3).

[225] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999, at 1-3; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 2-3. The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." *See* 15 U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b). Since 1996, out of an abundance of caution, the Commission has included small incumbent LECs in its regulatory flexibility analyses. *See, e.g.*, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket, 96-98, First Report and Order, 11 FCC Rcd 15499, 16144-45 (1996).

vices, as defined therein, for at least one year.[226] This number contains a variety of different categories of carriers, including local exchange carriers, interexchange carriers, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, PCS providers, covered SMR providers, and resellers. It seems certain that some of those 3,497 telephone service firms may not qualify as small entities or small incumbent LECs because they are not "independently owned and operated."[227] For example, a PCS provider that is affiliated with an interexchange carrier having more than 1,500 employees would not meet the definition of a small business. It seems reasonable to conclude, therefore, that fewer than 3,497 telephone service firms are small entity telephone service firms or small incumbent LECs that may be affected by the decisions and rule changes adopted in this proceeding.

107. *Wireline Carriers and Service Providers.* The SBA has developed a definition of small entities for telephone communications companies other than radiotelephone companies. The Census Bureau reports that there were 2,321 such telephone companies in operation for at least one year at the end of 1992.[228] According to the SBA's definition, a small business telephone company other than a radiotelephone company is one employing no more than 1,500 persons.[229] All but 26 of the 2,321 non-

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[226] United States Department of Commerce, Bureau of the Census, 1992 Census of Transportation, Communications, and Utilities: Establishment and Firm Size, at Firm Size 1-123 (1995) (*1992 Census*).

[227] 15 U.S.C. § 632(a)(1).

[228] *1992 Census* at Firm Size 1-123.

[229] 13 C.F.R. § 121.201, Standard Industrial Classification (SIC) Code 4813.

radiotelephone companies listed by the Census Bureau were reported to have fewer than 1,000 employees. Thus, even if all 26 of those companies had more than 1,500 employees, there would still be 2,295 non-radiotelephone companies that might qualify as small entities or small incumbent LECs. Although it seems certain that some of these carriers are not independently owned and operated, we are unable at this time to estimate with greater precision the number of wireline carriers and service providers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are fewer than 2,295 small entity telephone communications companies other than radiotelephone companies that may be affected by the decisions and rule changes adopted in this proceeding.

108. *Local Exchange Carriers, Interexchange Carriers, Competitive Access Providers, Operator Service Providers, and Resellers.* Neither the Commission nor the SBA has developed a definition particular to small LECs, interexchange carriers (IXCs), competitive access providers (CAPs), operator service providers (OSPs), or resellers. The closest applicable definition for these carrier-types under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[230] According to our most recent TRS data, there are 1,348 incumbent LECs and 212 CAPs and competitive LECs.[231] Although it seems certain that some of these carriers are not independently owned and operated, or have more than 1,500 employees, we are unable at this time to estimate with greater precision the number of these carriers that would qualify as small busi-

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[230] 13 C.F.R. § 121.201, SIC Code 4813.

[231] *Carrier Locator* at Fig. 1.

ness concerns under the SBA's definition. Consequently, we estimate that there are fewer than 1,348 incumbent LECs and fewer than 212 CAPs and competitive LECs that may be affected by the decisions and rule changes adopted in this proceeding.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

109. The rule we are adopting imposes direct compliance requirements on interconnected incumbent and competitive LECs, including small LECs. In order to comply with this rule, these entities will be required to exchange their ISP-bound traffic subject to the rules we are adopting above.

5. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

110. In the *Declaratory Ruling and Intercarrier Compensation NPRM* the Commission proposed various approaches to intercarrier compensation for ISP-bound traffic.[232] During the course of this proceeding the Commission considered and rejected several alternatives.[233] None of the significant alternatives considered would appear to succeed as much as our present rule in balancing our desire to minimize any significant economic impact on relevant small entities, with our desire to deal with the undesirable incentives created under the current reciprocal compensation regime that governs the exchange of ISP-bound traffic in most instances. We also find that for small ILECs and CLECs the administrative burdens and

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[232] *Declaratory Ruling*, 14 FCC Rcd at 3707-10.

[233] *See supra* paras. 67-76 (rejecting application of a reciprocal compensation mechanism to ISP-bound traffic).

transaction costs of intercarrier compensation will be minimized to the extent that LECs begin a transition toward recovery of costs from end-users, rather than other carriers.

111. Although a longer transition period was considered by the Commission, it was rejected because a three-year period was considered sufficient to accomplish our policy objectives with respect to all LECs.[234] Differing compliance requirements for small LECs or exemption from all or part of this rule is inconsistent with our policy goal of addressing the market distortions attributable to the prevailing intercarrier compensation mechanism for ISP-bound traffic and beginning a smooth transition to bill-and-keep.

Report to Congress: The Commission will send a copy of this Order on Remand and Report and Order, including this FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.[235] In addition, the Commission will send a copy of this Order on Remand and Report and Order, including the FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this Order on Remand and Report and Order and FRFA (or summaries thereof) will also be published in the Federal Register.[236]

VI. ORDERING CLAUSES

112. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i) and (j), 201-209, 251, 252, 332, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151,

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[234] We note, however, that the interim regime we adopt here governs for 36 months or until further action by the Commission, *whichever is longer.*

[235] 5 U.S.C. § 801(a)(1)(A).

[236] *See* 5 U.S.C. § 604(b).

154(i), 154(j), 201-209, 251, 252, 332, and 403, and Section 553 of Title 5, United States Code, 5 U.S.C. § 553, that this Order on Remand and Report and Order and revisions to Part 51 of the Commission's rules, 47 C.F.R. Part 51, ARE ADOPTED. This Order on Remand and Report and Order and the rule revisions adopted herein will be effective 30 days after publication in the Federal Register except that, for good cause shown, as set forth in paragraph 82 of this Order, the provision of this Order prohibiting carriers from invoking section 252(i) of the Act to opt into an existing interconnection agreement as it applies to rates paid for the exchange of ISP-bound traffic will be effective immediately upon publication of this Order in the Federal Register.

113. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Order on Remand and Report and Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

Appendix A

List of Commenters in CC Docket Nos. 96-98, 99-68

Comments Filed in Response to the June 23, 2000 Public Notice

Advanced TelCom Group, Inc.; e.spire Communications, Inc.; Intermedia Communications, Inc.; KMC Telecom, Inc.; Nextlink Communications, Inc.; The Competitive Telecommunications Association

Alliance for Public Technology

Association of Communications Enterprises

Association for Local Telecommunications Services

AT&T Corp. (AT&T)

BellSouth Corporation

Cablevision Lightpath, Inc.

California State and California Public Utilities Commission

Centennial Communications Corp. (Centennial)

Florida Public Service Commission

Focal Communications Corporation, Allegiance Telecom, Inc., and Adelphia Business Solutions, Inc.

General Services Administration

Global NAPs, Inc.

ICG Telecom Group, Inc.

Keep America Connected; National Association of the Deaf; National Association of Development Organizations; National Black Chamber of Commerce; New York Institute of Technology; Ocean of Know; Telecommunications for the Deaf, Inc.; United States Hispanic Chamber of Commerce

Massachusetts Department of Telecommunications & Energy

Missouri Public Service Commission

National Consumers League

National Exchange Carrier Association, Inc.
New York Department of Public Service
Pac-West Telecomm, Inc.
Pennsylvania Office of Consumer Advocate
Prism Communications Services, Inc.
Qwest Corporation
RCN Telecom Services, Inc. and Connect Communications Corporation
RNK, Inc.
Rural Independent Competitive Alliance
SBC Communications, Inc. (SBC)
Sprint Corporation (Sprint)
Texas Public Utility Commission
Time Warner Telecom Inc. (Time Warner)
United States Telecom Association
Verizon Communications (Verizon)
Western Telephone Integrated Communications, Inc.
WorldCom, Inc.

Reply Comments Filed in Response to the June 23, 2000 Public Notice

Adelphia Business Solutions, Inc.; Allegiance TeleCom, Inc., Focal Communications Corporation, and RCN Telcom Services, Inc.
AT&T Corp.
BellSouth Corporation
Cablevision Lightpath, Inc.
Cincinnati Bell Telephone Company
Commercial Internet Exchange Association
Conversecnt Communications, LLC
Covad Communication Company
Duckenfield, Pace
e.spire Communications, Inc., Intermedia Communications Inc., KMC Telecom, Inc., NEXTLINK Com-

munications, Inc., The Association for Local Telecommunications Services, and The Competitive Telecommunications Association

General Services Administration

Global NAPs, Inc.

ICG Telecom Group, Inc.

Keep America Connected; National Association of Development Organizations; National Black Chamber of Commerce; New York Institute of Technology; United States Hispanic Chamber of Commerce

Pac-West Telecomm, Inc.

Prism Communications Services, Inc.

Qwest Corporation

Riter, Josephine

SBC Communications, Inc. (SBC)

Sprint Corporation

Time Warner Telecom Inc. (Time Warner)

US Internet Industry Association

United States Telecom Association

Verizon Communications (Verizon)

Western Telephone Integrated Communications, Inc.

WorldCom, Inc.

Comments Filed in Response to the February 26, 1999 Notice of Proposed Rulemaking

Airtouch Paging

America Online, Inc. (AOL)

Ameritech

Association for Local Telecommunications Services

AT&T Corp. (AT&T)

Baldwin, Jesse

Bardsley, June

Bell Atlantic Corporation

BellSouth Corporation

Cablevision Lightpath, Inc.
California Public Utilities Commission
Choice One Communications (Choice One)
Cincinnati Bell Telephone Company
Commercial Internet eXchange Association
Competitive Telecommunications Association)
Corecomm Limited
Cox Communications, Inc. (Cox)
CT Cube, Inc. & Leaco Rural Telephone Cooperative, Inc.
CTSI, Inc.
Florida Public Service Commission
Focal Communications Corporation
Frontier Corporation
General Communication, Inc.
General Services Administration
Global NAPs Inc.
GST Telecom, Inc.
GTE Services Corporation (GTE)
GVNW Consulting, Inc.
Hamilton, Dwight
ICG Communications
ICORE, Inc.
Indiana Utility Regulatory Commission
Information Technology Association of America
Intermedia Communications Inc. (Intermedia)
Keep America Connected; Federation of Hispanic Organizations of the Baltimore Metropolitan Area, Inc; Latin American Women and Supporters; League of United Latin American Citizens; Massachusetts Assistive Technology Partnership; National Association of Commissions for Women; National Association of Development Organizations; National Hispanic Coun-

cil on Aging; New York Institute of Technology; Resources for Independent Living; Telecommunications Advocacy Project; The Child Health Foundation; The National Trust for the Development of African American Men; United Homeowners Association; United Seniors Health Cooperative

KMC Telecom Inc.

Lewis, Shawn

Lloyd, Kimberly, D.

MCI WorldCom, Inc.

MediaOne Group (Media One)

Miner, George

Missouri Public Service Commission

National Telephone Cooperative Association

New York State Department of Public Service

Pennsylvania Public Utility Commission

Personal Communications Industry Assoc.

Public Utility Commission of Texas

Prism Communications Services, Inc.

RCN Telecom Services, Inc.

Reinking, Jerome C.

Richmond Telephone Company

RNK Inc.

SBC Communications

Schaefer, Karl W.

Sefton, Tim

Shook, Ofelia E.

Sprint Corporation

John Staurulakis, Inc.

Telecommunications Resellers Association

Telephone Association of New England

Thomas, William J.

Time Warner Telecom Inc. (Time Warner)

United States Telephone Association
Verio Inc.
Vermont Public Service Board
Virgin Islands Telephone Corporation
Wisconsin State Telecommunications Association

Reply Comments Filed in Response to the February 26, 1999 Notice of Proposed Rulemaking

Airtouch Paging
Ameritech
Association for Local Telecommunications Services
AT&T Corp.
Bell Atlantic Corporation
BellSouth Corporation and BellSouth Telecommunications, Inc.
Competitive Telecommunications Association
Corecomm Limited (CoreComm)
Cox Communications, Inc. (Cox)
Focal Communications Corporation
General Services Administration
Global NAPs Inc.
GST Telecom Inc.
GTE Services Corporation (GTE)
GVNW Consulting, Inc.
ICG Communications, Inc
Illinois Commerce Commission
Intermedia Communications Inc.
KMC Telecom Inc.
MCI WorldCom, Inc.
National Exchange Carrier Association, Inc.
National Telephone Cooperative Association
Network Plus, Inc.
New York State Department of Public Services

Pac-West Telecomm., Inc.
Pennsylvania Public Utility Commission
Personal Communications Industry Association
Prism Communications Services, Inc.
Public Service Commission of Wisconsin
RCN Telecom Services
RNK Telecom
SBC Communications, Inc.
Sprint Corporation
Supra Telecommunications & Information Systems, Inc.
TDS Telecommunications Corporation
Time Warner Telecom
United States Telephone Association
US West Communications, Inc.
Verio Inc.
Virgin Islands Telephone Corporation
Wyoming Public Service Commission

Appendix B--Final Rules

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

Part 51, Subpart H, of Title 47 of the Code of Federal Regulations (C.F.R.) is amended as follows:

1. The title of part 51, Subpart H, is revised to read as follows:

Subpart H—Reciprocal Compensation for Transport and Termination of Telecommunications Traffic

2. Section 51.701(b) is revised to read as follows:

(a) **§ 51.701 Scope of transport and termination pricing rules.**

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(b) *Telecommunications traffic.* For purposes of this subpart, telecommunications traffic means:

(1) Telecommunications traffic exchanged between a LEC and a telecommunications carrier other than a CMRS provider, except for telecommunications traffic that is interstate or intrastate exchange access, information access, or exchange services for such access (see FCC 01-131, paras. 34, 36, 39, 42-43); or

(2) Telecommunications traffic exchanged between a LEC and a CMRS provider that, at the beginning of the call, originates and terminates within the same Major Trading Area, as defined in § 24.202(a) of this chapter.

3. Sections 51.701(a), 51.701(c) through (e), 51.703, 51.705, 51.707, 51.709, 51.711, 51.713, 51.715, and 51.717 are each amended by striking "local" before "telecommunications traffic" each place such word appears.

SEPARATE STATEMENT OF CHAIRMAN MICHAEL K. POWELL

Re: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic (CC Docket Nos. 96-98, 99-68)

In this *Order*, we reaffirm our prior conclusion that telecommunications traffic delivered to Internet service providers (ISPs) is subject to our jurisdiction under section 201 of the Act. Thus, we reject arguments that section 251(b)(5) applies to this traffic. I firmly believe that this *Order* is supported by reasonable interpretations of statutory provisions that read together are ambiguous and, absent a reconciling interpretation, conflicting.

I also support the fact that this *Order*, for the first time, establishes a transition mechanism that will gradually wean competitive carriers from heavy reliance on the excessive reciprocal compensation charges that incumbents have been forced to pay these competitors for carrying traffic from the incumbent to the ISP. This transition mechanism was carefully crafted to balance the competing interests of incumbent and competitive telephone companies and other parties, so as not to undermine the Act's goal of promoting efficient local telephone competition.

I write separately only to emphasize a few points:

As an initial matter, I respectfully disagree with the objections to our conclusion that section 251(g) "carves out" certain categories of services that, in the absence of that provision, would likely be subject to the requirements of section 251(b)(5).[1] Section 251(b)(5)'s language

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[1] To be more precise, section 251(g) refers to certain categories of service *provided by LECs to ISPs and interexchange carriers.* 47

first appears to be far-reaching, in that it would seem to apply, by its express terms, to all "telecommunications."[2] There is apparently no dispute, however, that at least one category of the LEC-provided telecommunications services enumerated in section 251(g) (namely, "exchange access") is not subject to section 251(b)(5), despite the broad language of this provision. Indeed, the *Bell Atlantic* Court appears to have endorsed that conclusion.[3] The question then arises whether the other categories of traffic that are enumerated in section 251(g) (including, "information access") should also be exempted from the application of section 251(b)(5). We answer this question in the affirmative, and no justification (compelling or otherwise) has been offered for why only one service—exchange access—should be afforded disparate treatment in the construction of section 251(g). I would note, moreover, that on the only other occasion in which the Commission directly addressed the question whether section 251(g) serves as such a "carve-out," the

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U.S.C. § 251(g). In this statement, I use a short-hand reference to the "categories of services" enumerated in section 251(g).

[2] 47 U.S.C. § 251(b)(5).

[3] *See cf. Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1, 4 (D.C. Cir. 2000) ("Although [section] 251(b)(5) purports to extend reciprocal compensation to all 'telecommunications,' the Commission has construed the reciprocal compensation requirement as limited to local traffic."). The Court then went on to conclude that the Commission had not provided an adequate explanation of why LECs that carry traffic to ISPs are providing "'exchange access,' rather than 'telephone exchange service.'" *Id.* at 9. The Court does not appear to have questioned anywhere in its opinion the notion that the scope of the reciprocal compensation requirement does not extend to certain categories of LEC-provided services, including "exchange access."

Commission concluded, as we do here, that it does perform that function.[4]

Nor do I find the position we adopt here irreconcilable with our decision in the *Advanced Services Remand Order*.[5] In discussing the term "information access" in that *Order*, we were not addressing the question whether section 251(g) exempts certain categories of traffic provided by LECs to ISPs and interexchange carriers from the other requirements of section 251. Rather, we addressed only the relationship between "information access" and the categories of "exchange access" and "telephone exchange service." Specifically, we "decline[d] to find that information access services are a separate category of services, distinct from, and mutually exclusive with, telephone exchange and exchange access services."[6] But under the reading of section 251(g) put forth in this *Order*, the question whether information access is distinct from these other services is irrelevant. Because information access is specifically enumerated in section 251(g), it is not subject to the requirements of section 251(b)(5), whether or not that category of service overlaps with, or is distinct from, telephone exchange service or exchange access.

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[4] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Dkt. Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499 (1996), ¶ 1034.

[5] *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Dkt. Nos. 98-147 et al., Order on Remand, 15 FCC Rcd 385 (1999) (*Advanced Services Remand Order*); *see also WorldCom, Inc. v. FCC*, No. 00-1002 (D.C. Cir. filed Apr. 20, 2001) (affirming *Advanced Services Remand Order* on one of the alternative grounds proffered by the Commission).

[6] *Advanced Services Remand Order*, 15 FCC Rcd at 406, ¶ 46.

Similarly, I reject the suggestion that section 251(g) *only* preserves the MFJ requirements. The language of section 251(g) specifically refers to "each local exchange carrier," not just to the Bell Operating Companies.[7] Section 251(g) also expressly refers to any "regulation, order, or policy of the Commission."[8] Such clauses support the reading of section 251(g) that we adopt today.[9]

Finally, I disagree that section 251(g) cannot be construed to exempt certain categories of traffic from the requirements of section 251(b)(5), simply because the former provision does not include the words "exclude" or "reciprocal compensation" or "telecommunications."[10] As I have said, our reading that the categories of LEC-provided services enumerated in subsection (g) are exempted from reciprocal compensation arises from our duty to give effect to both section 251(g) and section 251(b)(5). I also would point out that section 251(g) does include a specific reference to "receipt of compensation," just as the services enumerated in that section (*e.g.*, exchange access, information access) undeniably involve telecommunications.[11]

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[7] 47 U.S.C. § 251(g).

[8] *Id.*

[9] Had the language of section 251(g) been limited to the Bell Companies or to court orders and consent decrees, for example, perhaps one could construct an argument that Congress meant to limit the scope of section 251(g) to the MFJ requirements.

[10] Section 251(b)(5) states that all LECs must "establish *reciprocal compensation* arrangements for the transport and termination of *telecommunications*." 47 U.S.C. § 251(g) (emphasis added).

[11] As the *Order* suggests, Section 251(g) enumerates "exchange access," "information access" and "exchange services for such access." 47 U.S.C. § 251(g). For purposes of subsection (g), all of these services are provided by LECs to "interexchange carriers and informa-

In closing, I would only reiterate that the statutory provisions at issue here are ambiguous and, absent a reconciling interpretation, conflicting. Thus, the Commission has struggled long and hard in an effort to give as full a meaning as possible to each of the provisions in a manner we conclude is consistent with the statutory purpose. It would not be overstating matters to acknowledge that these issues are highly complex, disputed and elusive, and that what we decide here will have enormous impact on the development of new technologies and the economy more broadly. It is for their relentless efforts to wrestle with (and now resolve) these issues that I am deeply grateful to my colleagues and our able staff.

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tion service providers." These three categories undeniably involve telecommunications. "Information access" was defined in the MFJ as "the provision of specialized exchange *telecommunications* services" to information service providers. *United States v. AT&T*, 552 F. Supp. 131, 196, 229 (D.D.C. 1982). The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ. Rather, the term "exchange service" is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purposes of originating or terminating interexchange *telecommunications*." *United States v. AT&T*, F. Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. Consistent with that, in section 251(g), the term is used as part of the longer phrase "exchange services for such [exchange] access to interexchange carriers and information service providers." All of this indicates that the term "exchange service" is closely related to the provision of exchange access and information access, and that all three involve telecommunications.

DISSENTING STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH

Re: *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, CC Docket Nos. 96-98, 99-68.

To some observers, the Telecommunications Act of 1996 ("1996 Act"), in general, and sections 251 and 252 (47 U.S.C. §§ 251 and 252), in particular, have become unnecessary inconveniences. The poster child for those who proclaim the 1996 Act's failure is reciprocal compensation. It has led to large billings—some paid, some unpaid—among telecommunications carriers. These billings have not shrunk, in large part because the Commission's interpretation of the pick-and-choose provision of the Act (47 U.S.C. § 252(i)) has led to unstable contracts, with perverse incentives for renegotiation.

Reciprocal compensation is an obscure and tedious topic. It is not, however, a topic that Congress overlooked. To the contrary, in describing reciprocal compensation arrangements in sections 251 and 252, Congress went into greater detail than it did for almost any other commercial relationship between carriers covered in the 1996 Act. Among other things, Congress mandated that reciprocal compensation arrangements would be: (1) made by contract; (2) under State supervision; (3) at rates to be negotiated or arbitrated; and (4) would utilize a bill-and-keep plan only on a case-by-case basis under specific statutory conditions. *See* 47 U.S.C. §§ 251(b)(5), 252(a), 252(b), 252(d)(2).

Faced with these statutory mandates, how should the large billings for reciprocal compensation be addressed? Renegotiating contracts would be the simple market

solution, only made precarious by our pick-and-choose rules. Another solution would be to seek review of reciprocal compensation agreements by State commissions. Other solutions would be for this Commission to change its pick-and-choose rules or to issue guidelines for State commission decisions (*see AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 385 (1999)).

Each of these solutions, of course, would reflect at least a modicum of respect for States, their lawmakers, their regulators, federal law, and the Congress that enacted the 1996 Act. Each would also be consistent with, and respectful of, the prior ruling on reciprocal compensation by the Court of Appeals for the D.C. Circuit. *See Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

There is, however, one solution that is not respectful of other governmental institutions. It is a solution that places under exclusive federal jurisdiction broad expanses of telecommunications. It is a solution that does not directly solve the problem at hand. It is a solution that can be reached only through a twisted interpretation of the law and a vitiation of economic reasoning and general common sense. That solution is nationwide price regulation. That is the regrettable solution the Commission has adopted.

The Commission's decision has broad consequences for the future of telecommunications regulation. In holding that essentially all packetized communications fall within federal jurisdiction, the Commission has dramatically diminished the States' role going forward, as such communications are fast becoming the dominant mode. Whatever the merits of this reallocation of authority, it is a reallocation that properly should be made only by

Congress. It certainly should not be made, as here, by a self-serving federal agency acting unilaterally.

There is doubtlessly underway a publicity campaign by the proponents of today's action. It will spin nationwide mandatory price regulation as "deregulation." It will spin the abandonment of States and contracts as "good government."

The media might be spun by this campaign. The public might be spun. But it will be far more difficult to convince the courts that the current action is lawful.

A Flawed Order From Flawed Decisionmaking

Today's order is the product of a flawed decisionmaking process that occurs all too frequently in this agency. It goes like this. First, the Commission settles on a desired outcome, based on what it thinks is good "policy" and without giving a thought to whether that outcome is legally supportable. It then slaps together a statutory analysis. The result is an order like this one, inconsistent with the Commission's precedent and fraught with legal difficulties.

In March 2000, the Court of Appeals for the D.C. Circuit vacated the Commission's conclusion that section 251(b)(5) does not apply to calls made to Internet service providers ("ISPs"). *See Bell Atlantic*, 206 F.3d at 9. The court ruled that, among other things, the Commission had not provided a "satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as 'terminating . . . local telecommunications traffic,' and why such traffic is 'exchange access' rather than 'telephone exchange service.'" *Id.*

The Commission has taken more than a year to respond to the court's remand decision. My colleagues some time ago decided on their general objective—

asserting section 201(b) jurisdiction over ISP-bound traffic and permitting incumbent carriers to ramp down the payments that they make to competitive ones. The delay in producing an order is attributable to the difficulty the Commission has had in putting together a legal analysis to support this result, which is at odds with the agency's own precedent as well as the plain language of the statute.

Today, the Commission rules, once again, that section 251(b)(5) does not apply to ISP-bound traffic. In a set of convoluted arguments that sidestep the court's objections to its previous order, the Commission now says that ISP-bound traffic is "information access," which, the Commission asserts, is excluded "from the universe of 'telecommunications' referred to in section 251(b)(5)" (Order ¶¶ 23, 30)—despite the Commission's recent conclusion in another context that "information access" is not a separate category of service exempt from the requirements of section 251. *See Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Order on Remand, 15 FCC Rcd 385, ¶¶ 46-49 (1999) ("*Advanced Services Remand Order*").

The result will be another round of litigation, and, in all likelihood, this issue will be back at the agency in another couple of years. In the meantime, the uncertainty that has clouded the issue of compensation for ISP-bound traffic for the last five years will continue. The Commission would act far more responsibly if it simply recognized that ISP-bound traffic comes within section 251(b)(5). To be sure, this conclusion would mean that the Commission could not impose on these communications any rule that it makes up, as the agency believes it is permitted to do under section 201(b). Rather, the Commission would be forced to work within the confines

of sections 251(b)(5) and 252(d)(2), which, among other things, grant authority to State commissions to decide on "just and reasonable" rates for reciprocal compensation. 47 U.S.C. § 252(d)(2). But the Commission surely could issue "rules to guide the state-commission judgments" regarding reciprocal compensation (*Iowa Utilities Bd.*, 525 U.S. at 385) and perhaps could even put in place the same compensation scheme it orders here. At the same time, the confusion that this order will add to the agency's already bewildering precedent on Internet-related issues would be avoided.

The Commission's Previous Order and the Court's Remand Decision

To see how far the Commission has come in its attempt to assert section 201(b) jurisdiction over ISP-bound traffic, let us briefly review the court's decision on the Commission's previous order, which receives little attention in the order released today. In its previous order, issued in February 1999, the Commission focused on the jurisdictional nature of ISP-bound traffic. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic*, Declaratory Ruling, 14 FCC Rcd 3689 (1999) ("*Reciprocal Compensation Declaratory Ruling*"). Applying an "end-to-end" analysis, the agency concluded that calls to ISPs do not terminate at the ISP's local server, but instead continue to the "ultimate destination or destinations, specifically at a[n] Internet website that is often located in another state." *Id.* ¶ 12. Based on this jurisdictional analysis, the Commission ruled that a substantial portion of calls to ISPs are jurisdictionally interstate, and it described ISP-bound traffic as interstate "access service." *Id.* ¶¶ 17, 18. The Commission reasoned that, since reciprocal compen-

sation is required only for the transport and termination of local traffic, section 251(b)(5)'s obligations did not apply to ISP-bound calls. *See id.* ¶¶ 7, 26.

1. The Court Asked the Commission Why ISPs Are Not Like Other Local Businesses

The court vacated the Commission's decision. It held that, regardless of the jurisdictional issue, the Commission had not persuasively distinguished ISPs from other businesses that use communications services to provide goods or services to their customers. *See Bell Atlantic*, 206 F.3d at 7. In the court's view, the Commission had failed to explain why "an ISP is not, for purposes of reciprocal compensation, 'simply a communications-intensive business end user selling a product to other consumer and business end-users.'" *Id.* (citation omitted).

2. The Court Asked the Commission Why Calls Do Not Terminate at ISPs

The court also questioned the Commission's conclusion that a call to an ISP did not "terminate" at the ISP. "[T]he mere fact that the ISP originates further telecommunications does not imply that the original telecommunication does not 'terminate' at the ISP." *Id.* The court concluded that, "[h]owever sound the end-to-end analysis may be for jurisdictional purposes," the Commission had failed to explain why treating these "linked telecommunications as continuous works for purposes of reciprocal compensation." *Id.*

3. The Court Asked the Commission How Its Treatment of ISP-Bound Traffic Is Consistent with Its Treatment of Enhanced Service Providers

The court also wondered whether the Commission's treatment of ISP-bound traffic was consistent with the approach it applies to enhanced service providers

("ESPs"), which include ISPs. *See id.* at 7-8. The Commission has long exempted ESPs from the access charge system, effectively treating them as end-users of local service rather than long-distance carriers. The court observed that this agency, in the Eighth Circuit access charge litigation, had taken the position "that a call to an information service provider is really like a call to a local business that then uses the telephone to order wares to meet the need." *Id.* at 8. The court rejected as "not very compelling" the Commission's argument that the ESP exemption is consistent with the understanding that ESPs use interstate access services. *Id.*

4. **The Court Asked the Commission Whether ISP-Bound Traffic is "Exchange Access" or "Telephone Exchange Service"**

Finally, the court rejected the Commission's suggestion that ISPs are "users of access service." *Id.* The court noted that the statute creates two statutory categories—"telephone exchange service" and "exchange access"—and observed that on appeal, the Commission had conceded that these categories occupied the field. *Id.* If the Commission had meant to say that ISPs are users of "exchange access," wrote the court, it had "not provided a satisfactory explanation why this is the case." *Id.*

The Commission's Latest Order

Today, the Commission fails to answer any of the court's questions. Recognizing that it could not reach the desired result within the framework it used previously, the Commission offers up a completely new analysis, under which it is irrelevant whether ISP-bound traffic is "local" rather than "long-distance" or "telephone exchange service" rather than "exchange access."

In today's order, the Commission concludes that section 251(b)(5) is not limited to local traffic as it had previ-

ously maintained, but instead applies to all "telecommunications" traffic except the categories specifically enumerated in section 251(g). *See* Order ¶¶ 32, 34. The Commission concludes that ISP-bound traffic falls within one of these categories—"information access"—and is therefore exempt from section 251(b)(5). *See id.* ¶ 42. The agency wraps up with a determination that ISP-bound traffic is interstate, and it thus has jurisdiction under section 201(b) to regulate compensation for the exchange of ISP-bound traffic. *See id.* ¶¶ 52-65.

The Commission's latest attempt to solve the reciprocal compensation puzzle is no more successful than were its earlier efforts. As discussed below, its determination that ISP-bound traffic is "information access" and, hence, exempt from section 251(b)(5) is inconsistent with still-warm Commission precedent. Moreover, its interpretation of section 251(g) cannot be reconciled with the statute's plain language.

1. Today's decision is a complete reversal of the Commission's recent decision in the *Advanced Services Remand Order*. In that order, the Commission rejected an argument that xDSL traffic is exempt from the unbundling obligations of section 251(c)(3) as "information access." Among other things, the Commission found meritless the argument that section 251(g) exempts "information access" traffic from other requirements of section 251. *Id.* ¶ 47. Rather, the Commission explained, "this provision is merely a continuation of the equal access and nondiscrimination provisions of the Consent Decree until superseded by subsequent regulations of the Commission." *Id.* According to the Commission, section 251(g) "is a transitional enforcement mechanism that obligates the incumbent LECs to continue to abide by equal access and nondiscriminatory interconnection

requirements of the MFJ." *Id.* The Commission thus concluded that section 251(g) was not intended to exempt xDSL traffic from section 251's other provisions. *See id.* ¶¶ 47-49.

In addition, the Commission rejected the contention that "information access" is a statutory category distinct from "telephone exchange service" and "exchange access." *See id.* ¶ 46.[1] It pointed out that "'information access' is not a defined term under the Act, and is cross-referenced in only two transitional provisions." *Id.* ¶ 47. It ultimately concluded that nothing in the Act suggests that "information access" is a category of services mutually exclusive with exchange access or telephone exchange service. *See id.* ¶ 48.

The Commission further determined that ISP-bound traffic is properly classified as "exchange access." *See id.* ¶ 35. It noted that exchange access refers to "access to telephone exchange services or facilities for the purpose of originating or terminating communications that travel outside an exchange." *Id.* ¶ 15. Applying this definition, and citing the *Reciprocal Compensation Declaratory Ruling*, the Commission reasoned that the service provided by the local exchange carrier to an ISP is ordinarily exchange access service, "because it enables the ISP to transport the communication initiated by the end-user subscriber located in one exchange to its ultimate destination in another exchange, using both the services of the local exchange carrier and in the typical case the

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[1] This aspect of the *Advanced Services Remand Order* was remanded to the Commission by the D.C. Circuit because of its reliance on the vacated *Reciprocal Compensation Declaratory Ruling*. *See WorldCom, Inc. v. FCC*, No. 00-1062, 2001 WL 395344, *5-*6 (D.C. Cir. Apr 20, 2001).

telephone toll service of the telecommunications carrier responsible for the interexchange transport." *Id.* ¶ 35.

The *Advanced Services Remand Order* was appealed to the D.C. Circuit. *See WorldCom*, 2001 WL 395344. The Commission argued to the court in February that the term "information access" is merely "a holdover term from the MFJ, which the 1996 Act supersedes." *WorldCom, Inc. v. FCC*, Brief for Respondents at 50 (D.C. Cir. No. 00-1002). Its brief also emphasized that section 251(g) was "designed simply to establish a transition from the MFJ's equal access and nondiscrimination provisions . . . to the new obligations set out in the statute." *Id.*

Today, just two months after it made those arguments to the D.C. Circuit, the Commission reverses itself. It now says that section 251(g) exempts certain categories of traffic, including "information access," entirely from the requirements of section 251(b)(5) and that ISP-bound traffic is "information access." *See* Order ¶¶ 32, 34, 42. The Commission provides nary a word to explain this reversal.

Of course, the Commission's conclusions in the *Advanced Services Remand Order* that ISP-bound traffic is "exchange access" and that the term "information access" has no relevance under the 1996 Act were themselves reversals of earlier Commission positions. In the *Non-Accounting Safeguards Order*,[2] the Commission concluded, relying in part on a purported distinction between "exchange access" and "information access,"

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[2] *Implementation of the Non-Accounting Safeguards Of Sections 271 and 272 of the Communications Act of 1934, as Amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) ("*Non-Accounting Safeguards Order*").

that ISPs "do not use exchange access as it is defined by the Act." *Id.* ¶ 248. In that order, the Commission was faced with determining the scope of section 272(e)(2), which states that a Bell operating company ["BOC"] "shall not provide any facilities, services, or information regarding its provision of exchange access to [a BOC affiliate] unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions." 47 U.S.C. § 272(e)(2). The Commission rejected the argument that BOCs are required to provide exchange access to ISPs, reasoning that ISPs do not use exchange access. *See Non-Accounting Safeguards Order* ¶ 248. In making that decision, the Commission relied on the language of the statute as well as the MFJ's use of the term "information access." *See id.* ¶ 248 & n.621. As the Commission explained, its "conclusion that ISPs do not use exchange access is consistent with the MFJ, which recognized a difference between 'exchange access' and 'information access.'" *Id.* ¶ 248 n.621.

Thus, in reversing itself yet again, the Commission here follows a time-honored tradition. When it is expedient to say that ISPs use "exchange access" and that there is no such thing as "information access," that is what the Commission says. *See Advanced Service Remand Order* ¶¶ 46–48. When it is convenient to say that ISPs use the local network like local businesses, then the Commission adopts that approach. *See Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, ¶ 345 (1997). And, today, when it helps to write that ISPs use "information access," then that is what the Commission writes. The only conclusion that one can soundly draw from these decisions is that the Com-

mission is willing to make up whatever law it can dream up to suit the situation at hand.

Nevertheless, there is one legal proposition that the Commission has, until now, consistently followed—a fact that is particularly noteworthy given the churn in the Commission's other legal principles. The Commission has consistently held that section 251(g) serves only to "preserve[ ] the LECs' existing equal access obligations, originally imposed by the MFJ." *Operator Communications, Inc., D/B/A Oncor Comunications*, Memorandum Opinion and Order, 14 FCC Rcd 12506, ¶ 2 n.5 (1999).[8] Today's order ignores this precedent and transforms section 251(g) into a categorical exemption for certain traffic from section 251(b)(5). It is this transformation—much more than the shell game played with "information access" and "exchange access"—that is most offensive in today's decision.

2. The Commission's claim that section 251(g) "excludes several enumerated categories of traffic from the universe of 'telecommunications' referred to in section

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[8] *See also, e.g., Application for Review and Petition for Reconsideration or Clarification of Declaratory Ruling Regarding U S West Petitions To Consolidate Latas in Minnesota and Arizona*, Memorandum Opinion and Order, 14 FCC Rcd 14392, ¶ 17 (1999) ("In section 251(g), Congress delegated to the Commission sole authority to administer the 'equal access and nondiscriminatory interconnection restrictions and obligations' that applied under the AT&T Consent Decree."); *AT&T Corporation, et al., Complainants*, Memorandum Opinion and Order, 13 FCC Rcd 21438, ¶ 5 (1998) ("Separately, section 251(g) requires the BOCs, both pre- and post-entry, to treat all interexchange carriers in accordance with their preexisting equal access and nondiscrimination obligations, and thereby neutralize the potential anticompetitive impact they could have on the long distance market until such time as the Commission finds it reasonable to revise or eliminate those obligations.").

251(b)(5)" (Order ¶ 23) stretches the meaning of section 251(g) past the breaking point. Among other things, that provision does not even mention "exclud[ing]," "telecommunications," "section 251(b)(5)," or "reciprocal compensation."

Section 251(g), which is entitled, "Continued enforcement of exchange access and interconnection requirements," states in relevant part:

> On and after February 8, 1996, each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996 under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996.

47 U.S.C. § 251(g).

As an initial matter, it is plain from reading this language that section 251(g) has absolutely no application to the vast majority of local exchange carriers, including those most affected by today's order. The provision states that "each local exchange carrier . . . shall provide [the enumerated services] . . . in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations . . . *that apply to such carrier on the date immediately preceding February 8, 1996.*" *Id.* (emphasis added). If a carrier was not providing service on February 7, 1996, no restrictions or obligations

applied to "such carrier" on that date, and section 251(g) would appear to have no impact on that carrier. The Commission has thus repeatedly stated that section 251(g) applies to "Bell Operating Companies" and is intended to incorporate aspects of the MFJ. *Applications For Consent To The Transfer Of Control Of Licenses And Section 214 Authorizations From TeleCommunications, Inc., Transferor To AT&T Corp., Transferee.*, Memorandum Opinion and Order, 14 FCC Rcd 3160, ¶ 53 (1999); *see also* cases cited *supra* note 3. Accordingly, by its express terms, section 251(g) says nothing about the obligations of most CLECs serving ISPs, which are the primary focus of the Commission's order.

Moreover, it is inconceivable that section 251(g)'s preservation of pre-1996 Act "equal access and nondiscriminatory interconnection restrictions and obligations" is intended to displace section 251(b)(5)'s explicit compensation scheme for local carriers transporting and terminating each other's traffic. Prior to passage of the 1996 Act, there were no rules governing compensation for such services, whether or not an ISP was involved. It seems unlikely, at best, that Congress intended the absence of a compensation scheme to preempt a provision explicitly providing for such compensation.[4] At the very

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[4] The case of IXC traffic is thus completely different. There was a compensation scheme in effect for such traffic prior to enactment of the 1996 Act—the access charge regime. Because reciprocal compensation and the access charge regime could not both apply to the same traffic, the Commission could reasonably conclude that the access charge regime should trump the reciprocal compensation provision of section 251(b)(5). *See Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068, 1072-73 (8th Cir. 1997). Here, there is no pre-1996 Act compensation scheme to conflict with reciprocal compensation. As the Commission has stated, "the Commission has never applied either the ESP exemption or its rules regarding the

least, one would think Congress would use language more explicit than that seized upon by the Commission in section 251(g).

Finally, if, as the Commission maintains, section 251(g) "excludes several enumerated categories of traffic from the universe of 'telecommunications' referred to in section 251(b)(5)" (Order ¶ 23), why does section 251(g) not also exclude this traffic from the "universe of 'telecommunications'" referred to in the rest of section 251, or, indeed, in the entire 1996 Act? As noted, section 251(g) nowhere mentions "reciprocal compensation" or even "section 251." In fact, there appears to be no limiting principle. It would thus seem that, under the Commission's interpretation, the traffic referred to in section 251(g) is exempt from far more than reciprocal compensation—a consequence the Commission is sure to regret. *See, e.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-connection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, First Report and Order 11 FCC Rcd 15499, ¶ 356 (1996) (concluding that "exchange access" provided to IXCs is subject to the unbundling requirements of section 251(c)(3)).

* * *

The end result of today's decision is clear. There will be continued litigation over the status of ISP-bound traffic, prolonging the uncertainty that has plagued this issue for years. At the same time, the Commission will be forced to reverse itself yet again, as soon as it dislikes

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joint provision of access to the situation where two carriers collaborate to deliver traffic to an ISP." *Reciprocal Compensation Declaratory Ruling* ¶ 26.

the implication of treating ISP-bound traffic as "information access" or reading section 251(g) as a categorical exemption from other requirements of the 1996 Act. The Commission could, and should, have avoided these consequences by applying its original analysis in the manner sought by the court.

APPENDIX J
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

NOS. 99-1094, 99-1095, 99-1097, 99-1106, 99-1126, 99-1134, 99-1136 AND 99-1145.

BELL ATLANTIC TELEPHONE COMPANIES,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

TELECOMMUNICATIONS RESELLERS ASSOCIATION, ET AL.,
Intervenors,

ARGUED NOV. 22, 1999
DECIDED MARCH 24, 2000

On Petitions for Review of a Declaratory Ruling of the Federal Communications Commission

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Before: WILLIAMS, SENTELLE and RANDOLPH, Circuit Judges.

Opinion for the Court filed by Circuit Judge STEPHEN F. WILLIAMS.

STEPHEN F. WILLIAMS, Circuit Judge:

The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151-714, requires local exchange carriers ("LECs") to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." *Id.* § 251(b)(5). When LECs collaborate to complete a call, this provision ensures compensation both for the originating LEC, which receives payment from the end-user, and for the recipient's LEC. By regulation the Commission has limited the scope of the reciprocal compensation requirement to "local telecommunications traffic." 47 CFR § 51.701(a). In the ruling under review, it considered whether calls to internet service providers ("ISPs") within the caller's local calling area are themselves "local." In doing so it applied its so-called "end-to-end" analysis, noting that the communication characteristically will ultimately (if indirectly) extend beyond the ISP to websites out-of-state and around the world. Accordingly it found the calls non-local. See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689, 3690 (¶ 1) (1999) ("FCC Ruling").

Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for "reciprocal compensation" (as it interpreted it), the Commission could nonetheless itself have set rates for such calls, but it elected not to. In a Notice of Proposed Rulemaking, CC Docket 99-68, the Commission tentatively concluded that "a negotiation process, driven by market forces, is more likely to lead to efficient outcomes than are rates set by regulation," FCC Ruling, 14 FCC Rcd at 3707 (¶ 29), but for the nonce it left open the matter of implementing a system of federal controls. It

observed that in the meantime parties may voluntarily include reciprocal compensation provisions in their interconnection agreements, and that state commissions, which have authority to arbitrate disputes over such agreements, can construe the agreements as requiring such compensation; indeed, even when the agreements of interconnecting LECs include no linguistic hook for such a requirement, the commissions can find that reciprocal compensation is appropriate. FCC Ruling, 14 FCC Rcd at 3703-05 (¶¶ 24-25); see § 251(b)(1) (establishing such authority). "[A]ny such arbitration," it added, "must be consistent with governing federal law." FCC Ruling, 14 FCC Rcd at 3705 (¶ 25).

This outcome left at least two unhappy groups. One, led by Bell Atlantic, consists of incumbent LECs (the "incumbents"). Quite content with the Commission's finding of § 251(b)(5)'s inapplicability, the incumbents objected to its conclusion that in the absence of federal regulation state commissions have the authority to impose reciprocal compensation. Although the Commission's new rulemaking on the subject may eventuate in a rule that preempts the states' authority, the incumbents object to being left at the mercy of state commissions until that (hypothetical) time, arguing that the commissions have mandated exorbitant compensation. In particular, the incumbents, who are paid a flat monthly fee, have generally been forced to provide compensation for internet calls on a per-minute basis. Given the average length of such calls the cost can be substantial, and since ISPs do not make outgoing calls, this compensation is hardly "reciprocal."

Another group, led by MCI WorldCom, consists of firms that are seeking to compete with the incumbent LECs and which provide local exchange telecommuni-

cations services to ISP's (the "competitors"). These firms, which stand to receive reciprocal compensation on ISP-bound calls, petitioned for review with the complaint that the Commission erred in finding that the calls weren't covered by § 251(b)(5).

The end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate *jurisdiction*. Here it used the analysis for quite a different purpose, without explaining why such an extension made sense in terms of the statute or the Commission's own regulations. Because of this gap, we vacate the ruling and remand the case for want of reasoned decisionmaking.

* * *

In February 1996 Congress passed the Telecommunications Act of 1996 (the "1996 Act" or the "Act"), stating an intent to open local telephone markets to competition. See H.R. Conf. Rep. No. 104-458, at 113 (1996). Whereas before local exchange carriers generally had state-licensed monopolies in each local service area, the 1996 Act set out to ensure that "[s]tates may no longer enforce laws that impede[ ] competition," and subjected incumbent LECs "to a host of duties intended to facilitate market entry." *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 119 S. Ct. 721, 726, 142 L. Ed. 2d 835 (1999).

Among the duties of incumbent LECs is to "provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network . . . for the transmission and routing of telephone exchange service and exchange access." 47 U.S.C. § 251(c)(2). ("Telephone exchange service" and "exchange access" are words of art to which we shall later return.) Competitor LECs have sprung in-

to being as a result, and their customers call, and receive calls from, customers of the incumbents.

We have already noted that § 251(b)(5) of the Act establishes the duty among local exchange carriers "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). Thus, when a customer of LEC A calls a customer of LEC B, LEC A must pay LEC B for completing the call, a cost usually paid on a per-minute basis. Although § 251(b)(5) purports to extend reciprocal compensation to all "telecommunications," the Commission has construed the reciprocal compensation requirement as limited to local traffic. See 47 CFR § 51.701(a) ("The provisions of this subpart apply to reciprocal compensation for transport and termination of local telecommunications traffic between LECs and other telecommunications carriers."). LECs that originate or terminate long-distance calls continue to be compensated with "access charges," as they were before the 1996 Act. Unlike reciprocal compensation, these access charges are not paid by the originating LEC. Instead, the long-distance carrier itself pays both the LEC that originates the call and links the caller to the long distance network, and the LEC that terminates the call. See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16013 (¶ 1034) (1996) ("*Local Competition Order*").

The present case took the Commission beyond these traditional telephone service boundaries. The internet is "an international network of interconnected computers that enables millions of people to communicate with one another in 'cyberspace' and to access vast amounts of information from around the world." *Reno v. ACLU*, 521 U.S. 844, 844, 117 S. Ct. 2329, 138 L. Ed. 2d 874 (1997).

Unlike the conventional "circuit-switched network," which uses a single end-to-end path for each transmission, the internet is a "distributed packet-switched network, which means that information is split up into small chunks or 'packets' that are individually routed through the most efficient path to their destination." *In the Matter of Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11532 (¶ 64) (1998) ("*Universal Service Report*"). ISPs are entities that allow their customers access to the internet. Such a customer, an "end user" of the telephone system, will use a computer and modem to place a call to the ISP server in his local calling area. He will usually pay a flat monthly fee to the ISP (above the flat fee already paid to his LEC for use of the local exchange network). The ISP "typically purchases business lines from a LEC, for which it pays a flat monthly fee that allows unlimited incoming calls." FCC Ruling, 14 FCC Rcd at 3691 (¶ 4).

In the ruling now under review, the Commission concluded that § 251(b)(5) does not impose reciprocal compensation requirements on incumbent LECs for ISP-bound traffic. FCC Ruling, 14 FCC Rcd at 3690 (¶ 1). Faced with the question whether such traffic is "local" for purposes of its regulation limiting § 251(b)(5) reciprocal compensation to local traffic, the Commission used the "end-to-end" analysis that it has traditionally used for jurisdictional purposes to determine whether particular traffic is interstate. Under this method, it has focused on "the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers." FCC Ruling, 14 FCC Rcd at 3695 (¶ 10). We save for later an analysis of the various FCC precedents

on which the Commission purported to rely in choosing this mode of analysis.

Before actually applying that analysis, the Commission brushed aside a statutory argument of the competitor LECs. They argued that ISP-bound traffic must be either "telephone exchange service," as defined in 47 U.S.C. § 153(47), or "exchange access," as defined in § 153(16).[1] It could not be the latter, they reasoned, because ISPs do not assess toll charges for the service (see *id.*, "the offering of access . . . for the purpose of the origination or termination of telephone toll services"), and therefore it must be the former, for which reciprocal compensation is mandated. Here the Commission's answer was that it has consistently treated ISPs (and ESPs generally) as "users of access service," while treating them as end users merely for access charge purposes. FCC Ruling, 14 FCC Rcd at 3701 (¶ 17).

Having decided to use the "end-to-end" method, the Commission considered whether ISP-bound traffic is, under this method, in fact interstate. In a conventional "circuit-switched network," the jurisdictional analysis is

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[1] "Telephone exchange service" is defined as:

> (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.

47 U.S.C. § 153(47). "Exchange access" is defined as:

> the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services.

Id. § 153(16).

straightforward: a call is intrastate if, and only if, it originates and terminates in the same state. In a "packet-switched network," the analysis is not so simple, as "[a]n Internet communication does not necessarily have a point of 'termination' in the traditional sense." FCC Ruling, 14 FCC Rcd at 3701-02 (¶ 18). In a single session an end user may communicate with multiple destination points, either sequentially or simultaneously. Although these destinations are sometimes intrastate, the Commission concluded that "a substantial portion of Internet traffic involves accessing interstate or foreign websites." *Id.* Thus reciprocal compensation was not due, and the issue of compensation between the two local LECs was left initially to the LECs involved, subject to state commissions' power to order compensation in the "arbitration" proceedings, and, of course to whatever may follow from the Commission's new rulemaking on its own possible ratesetting.

* * *

The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly. The Commission has described local calls, on the one hand, as those in which LECs collaborate to complete a call and are compensated for their respective roles in completing the call, and long-distance calls, on the other, as those in which the LECs collaborate with a long-distance carrier, which itself charges the end-user and pays out compensation to the LECs. See *Local Competition Order*, 11 FCC Rcd at 16013 (¶ 1034) (1996).

Calls to ISPs are not quite local, because there is some communication taking place between the ISP and out-of-state websites. But they are not quite long-distance, because the subsequent communication is not really a continuation, in the conventional sense, of the initial call to

the ISP. The Commission's ruling rests squarely on its decision to employ an end-to-end analysis for purposes of determining whether ISP-traffic is local. There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate. But it has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

In fact, the extension of "end-to-end" analysis from jurisdictional purposes to the present context yields intuitively backwards results. Calls that are jurisdictionally *intra*state will be subject to the federal reciprocal compensation requirement, while calls that are *inter*state are not subject to federal regulation but instead are left to potential state regulation. The inconsistency is not necessarily fatal, since under the 1996 Act the Commission has jurisdiction to implement such provisions as § 251, even if they are within the traditional domain of the states. See *AT&T Corp.*, 119 S. Ct. at 730. But it reveals that arguments supporting use of the end-to-end analysis in the jurisdictional analysis are not obviously transferable to this context.

In attacking the Commission's classification of ISP-bound calls as non-local for purposes of reciprocal compensation, MCI WorldCom notes that under 47 CFR § 51.701(b)(1) "telecommunications traffic" is local if it "originates and terminates within a local service area." But, observes MCI WorldCom, the Commission failed to apply, or even to mention, its definition of "termination," namely "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or

equivalent facility) and delivery of that traffic from that switch to the called party's premises." *Local Competition Order*, 11 FCC Rcd at 16015 (¶ 1040); 47 CFR § 51.701(d). Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the "called party."

In its ruling the Commission avoided this result by analyzing the communication on an end-to-end basis: "[T]he communications at issue here do not terminate at the ISP's local server . . . , but continue to the ultimate destination or destinations." FCC Ruling, 14 FCC Rcd at 3697 (¶ 12). But the cases it relied on for using this analysis are not on point. Both involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination. One, *Teleconnect Co. v. Bell Telephone Co.*, 10 FCC Rcd 1626 (1995), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997) ("*Teleconnect*"), involved an 800 call to a long-distance carrier, which then routed the call to its intended recipient. The other, *In the Matter of Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corporation*, 7 FCC Rcd 1619 (1992), considered a voice mail service. Part of the service, the forwarding of the call from the intended recipient's location to the voice mail apparatus and service, occurred entirely within the subscriber's state, and thus looked local. Looking "end-to-end," however, the Commission refused to focus on this portion of the call but rather considered the service in its entirety (i.e., originating with the out-of-state caller leaving a message, or the subscriber calling from out-of-state to retrieve messages). *Id.* at 1621 (¶ 12).

ISPs, in contrast, are "information service providers," *Universal Service Report*, 13 FCC Rcd at 11532-33 (¶ 66), which upon receiving a call originate further communications to deliver and retrieve information to and from distant websites. The Commission acknowledged in a footnote that the cases it relied upon were distinguishable, but dismissed the problem out-of-hand: "Although the cited cases involve interexchange carriers rather than ISPs, and the Commission has observed that 'it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs,' *Access Charge Reform Order*, 12 FCC Rcd at 16133, the Commission's observation does not affect the jurisdictional analysis." FCC Ruling, 14 FCC Rcd at 3697 n.36 (¶ 12). It is not clear how this helps the Commission. Even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation. Although ISPs use telecommunications to provide information service, they are not themselves telecommunications providers (as are long-distance carriers).

In this regard an ISP appears, as MCI WorldCom argued, no different from many businesses, such as "pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies," which use a variety of communication services to provide their goods or services to their customers. Comments of WorldCom, Inc. at 7 (July 17, 1997). Of course, the ISP's origination of telecommunications as a result of the user's call is instantaneous (although perhaps no more so than a credit card verification system or a bank account information service). But this does not imply that the original communication does not "terminate" at the ISP. The Commission has not satisfactorily explained why an ISP

is not, for purposes of reciprocal compensation, "simply a communications-intensive business end user selling a product to other consumer and business end-users." *Id.*

The Commission nevertheless argues that although the call from the ISP to an out-of-state website is information service for the end-user, it is telecommunications for the ISP, and thus the telecommunications cannot be said to "terminate" at the ISP. As the Commission states: "Even if, from the perspective of the *end user* as customer, the telecommunications portion of an Internet call 'terminates' at the ISP's server (and information service begins), the remaining portion of the call would continue to constitute telecommunications from the perspective of the *ISP* as customer." Commission's Br. at 41. Once again, however, the mere fact that the ISP originates further telecommunications does not imply that the original telecommunication does not "terminate" at the ISP. However sound the end-to-end analysis may be for jurisdictional purposes, the Commission has not explained why viewing these linked telecommunications as continuous works for purposes of reciprocal compensation.

Adding further confusion is a series of Commission rulings dealing with a class, enhanced service providers ("ESPs"), of which ISPs are a subclass. See FCC Ruling, 14 FCC Rcd at 3689 n.1 (¶ 1). ESPs, the precursors to the 1996 Act's information service providers, offer data processing services, linking customers and computers via the telephone network. See *MCI Telecommunications Corp. v. FCC*, 57 F.3d 1136, 1138 (D.C. Cir. 1995).[2] In its

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[2] The regulatory definition states that ESPs offer "services ... which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different,

establishment of the access charge system for long-distance calls, the Commission in 1983 exempted ESPs from the access charge system, thus in effect treating them like end users rather than long-distance carriers. See *In the Matter of MTS & WATS Market Structure*, 97 F.C.C.2d 682, 711-15 (¶ 77-83), 1983 WL 183026 (1983). It reaffirmed this decision in 1991, explaining that it had "refrained from applying full access charges to ESPs out of concern that the industry has continued to be affected by a number of significant, potentially disruptive, and rapidly changing circumstances." *In the Matter of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture*, 6 FCC Rcd 4524, 4534 (¶ 54) (1991). In 1997 it again preserved the status quo. *In the Matter of Access Charge Reform*, 12 FCC Rcd 15982 (1997) ("*Access Charge Reform Order*"). It justified the exemption in terms of the goals of the 1996 Act, saying that its purpose was to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services." *Id.* at 16133 (¶ 344) (quoting 47 U.S.C. § 230(b)(2)).

This classification of ESPs is something of an embarrassment to the Commission's present ruling. As MCI WorldCom notes, the Commission acknowledged in the *Access Charge Reform Order* that "given the evolution in [information service provider] technologies and markets since we first established access charges in the early 1980s, it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs [inter-exchange carriers]." 12 FCC Rcd at 16133 (¶ 345). It also referred to calls to information service

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or restructured information; or involve subscriber interaction with stored information." 47 CFR § 64.702(a).

providers as "local." *Id.* at 16132 (¶ 342 n.502). And when this aspect of the *Access Charge Reform Order* was challenged in the 8th Circuit, the Commission's brief-writers responded with a sharp differentiation between such calls and ordinary long-distance calls covered by the "end-to-end" analysis, and even used the analogy employed by MCI WorldCom here—that a call to an information service provider is really like a call to a local business that then uses the telephone to order wares to meet the need. Brief of FCC at 76, *Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998) (No. 97-2618). When accused of inconsistency in the present matter, the Commission flipped the argument on its head, arguing that its exemption of ESPs from access charges actually confirms "its understanding that ESPs in fact use interstate access service; otherwise, the exemption would not be necessary." FCC Ruling, 14 FCC Rcd at 3700 (¶ 16). This is not very compelling. Although, to be sure, the Commission used policy arguments to justify the "exemption," it also rested it on an acknowledgment of the real differences between long-distance calls and calls to information service providers. It is obscure why those have now dropped out of the picture.

Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling, *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983); 5 U.S.C. § 706(2)(A), we must vacate the ruling and remand the case.

There is an independent ground requiring remand—the fit of the present rule within the governing statute. MCI WorldCom says that ISP-traffic is "telephone exchange service[ ]" as defined in 47 U.S.C. § 153(16), which it claims "is synonymous under the Act with the service

used to make local phone calls," and emphatically not "exchange access" as defined in 47 U.S.C. § 153(47). Petitioner MCI WorldCom's Initial Br. at 22. In the only paragraph of the ruling in which the Commission addressed this issue, it merely stated that it "consistently has characterized ESPs as 'users of access service' but has treated them as end users for pricing purposes." FCC Ruling, 14 FCC Rcd at 3701 (¶ 17). In a statutory world of "telephone exchange *service*" and "exchange *access*," which the Commission here says constitute the only possibilities, the reference to "access service," combining the different key words from the two terms before us, sheds no light. "Access service" is in fact a pre-Act term, defined as "services and facilities provided for the origination or termination of any interstate or foreign telecommunication." 47 CFR § 69.2(b).

If the Commission meant to place ISP-traffic within a third category, not "telephone exchange service" and not "exchange access," that would conflict with its concession on appeal that "exchange access" and "telephone exchange service" occupy the field. But if it meant that just as ESPs were "users of access service" but treated as end users for pricing purposes, so too ISPs are users of exchange access, the Commission has not provided a satisfactory explanation why this is the case. In fact, in *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, 22023 (¶ 248) (1996), the Commission clearly stated that "ISPs do not use exchange access." After oral argument in this case the Commission overruled this determination, saying that "non-carriers may be purchasers of those services." *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*,

FCC 99-413, at 21 (¶ 43) (Dec. 23, 1999). The Commission relied on its preAct orders in which it had determined that non-carriers can use "access services," and concluded that there is no evidence that Congress, in codifying "exchange access," intended to depart from this understanding. See *id.* at 21-22 (¶ 44). The Commission, however, did not make this argument in the ruling under review.

Nor did the Commission even consider how regarding noncarriers as purchasers of "exchange access" fits with the statutory definition of that term. A call is "exchange access" if offered "for the purpose of the origination or termination of *telephone toll services*." 47 U.S.C. § 153(16). As MCI WorldCom argued, ISPs provide information service rather than telecommunications; as such, "ISPs connect to the local network 'for the purpose of' providing information services, not originating or terminating telephone toll services." Petitioner MCI WorldCom's Reply Br. at 6.

The statute appears ambiguous as to whether calls to ISPs fit within "exchange access" or "telephone exchange service," and on that view any agency interpretation would be subject to judicial deference. See *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984). But, even though we review the agency's interpretation only for reasonableness where Congress has not resolved the issue, where a decision "is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service." *SEC v. Chenery Corp.*, 318 U.S. 80, 88, 63 S. Ct. 454, 87 L. Ed. 626 (1943). See also *Acme Die Casting v. NLRB*, 26 F.3d 162, 166 (D.C. Cir. 1994); *Leeco, Inc. v. Hays*, 965 F.2d

1081, 1085 (D.C. Cir. 1992); *City of Kansas City v. Department of Housing and Urban Development*, 923 F.2d 188, 191-92 (D.C. Cir. 1991).

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Because the Commission has not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as "terminat[ing] . . . local telecommunications traffic," and why such traffic is "exchange access" rather than "telephone exchange service," we vacate the ruling and remand the case to the Commission. We do not reach the objections of the incumbent LECs—that § 251(b)(5) preempts state commission authority to compel payments to the competitor LECs; at present we have no adequately explained classification of these communications, and in the interim our vacatur of the Commission's ruling leaves the incumbents free to seek relief from state-authorized compensation that they believe to be wrongfully imposed.

So ordered.

APPENDIX K
BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FCC 99-38

IN THE MATTER OF

IMPLEMENTATION OF THE LOCAL
COMPETITION PROVISIONS IN THE
TELECOMMUNICATIONS ACT OF 1996
CC DOCKET NO. 96-98

INTER-CARRIER COMPENSATION
FOR ISP-BOUND TRAFFIC
CC DOCKET NO. 99-68

DECLARATORY RULING IN CC DOCKET NO. 96-98
AND NOTICE OF PROPOSED RULEMAKING
IN CC DOCKET NO. 99-68

ADOPTED: FEBRUARY 25, 1999
RELEASED: FEBRUARY 26, 1999

NPRM COMMENT DATE: APRIL 12, 1999
NPRM REPLY DATE: APRIL 27, 1999

By the Commission: Commissioner Ness issuing a statement; Commissioner Furchtgott-Roth not participating; and Commissioner Powell concurring and issuing a statement.

I. INTRODUCTION

1. The Commission and the Common Carrier Bureau (Bureau) have received a number of requests to clarify whether a local exchange carrier (LEC) is entitled to receive reciprocal compensation for traffic that it delivers to an information service provider, particularly an Internet service provider (ISP).[1] Generally, competitive LECs

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[1] *See, e.g.*, Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53,922 (1996); Petition for Partial Reconsideration and Clarification of MFS Communications Co., Inc. at 28; Letter from Richard J. Metzger, General Counsel for ALTS, to Regina M. Keeney, Chief, Common Carrier Bureau, FCC (June 20, 1997) (ALTS Letter); Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CCB/CPD 97-30, DA 97-1399 (rel. July 2, 1997) (*ALTS Letter Notice*); Letter from Edward D. Young, Senior Vice President & Deputy General Counsel for Bell Atlantic, and Thomas J. Tauke, Senior Vice President—Government Relations for Bell Atlantic, to Hon. William E. Kennard, Chairman, FCC (July 1, 1998). This question sometimes has been posed more narrowly, *i.e.*, whether an incumbent LEC must pay reciprocal compensation to a competitive LEC (CLEC) that delivers incumbent LEC-originated traffic to ISPs. Because the pertinent provision of the 1996 Act pertains to all LECs, we examine this issue in the broader context. 47 U.S.C. § 251(b)(5).

For purposes of this Declaratory Ruling, we refer to providers of enhanced services and providers of information services as ESPs, a category which includes Internet service providers, which we refer to here as ISPs. As the Commission stated in the *Access Charge Reform Order*, the term "enhanced services," defined in the Commission's rules as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information," 47 C.F.R. § 64.702(a), is quite similar to "information services," defined in the Act as offering "a capability for generating, acquiring, storing,

(CLECs) contend that this is local traffic subject to the reciprocal compensation provisions of section 251(b)(5) of the Communications Act of 1934 (Act), as amended by the Telecommunications Act of 1996.[2] Incumbent LECs contend that this is interstate traffic beyond the scope of section 251(b)(5). After reviewing the record developed in response to these requests, we conclude that ISP-bound traffic is jurisdictionally mixed and appears to be largely interstate. This conclusion, however, does not in itself determine whether reciprocal compensation is due in any particular instance. As explained below, parties may have agreed to reciprocal compensation for ISP-bound traffic, or a state commission, in the exercise of its authority to arbitrate interconnection disputes under section 252 of the Act, may have imposed reciprocal compensation obligations for this traffic. In the absence, to date, of a federal rule regarding the appropriate inter-carrier compensation for this traffic, we therefore conclude that parties should be bound by their existing interconnection agreements, as interpreted by state commissions.

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transforming, processing, retrieving, utilizing, or making available information via telecommunications." 47 U.S.C. § 153(20). Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 16131-32 n.498 (1997) (*Access Charge Reform Order*), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998). *See also* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, at 11516 (1998) (*Universal Service Report to Congress*) (reiterating Commission's conclusion that the 1996 Act's definitions of telecommunications services and information services "essentially correspond to the pre-existing categories of basic and enhanced services").

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. § 151 *et seq.* (1996 Act).

II. BACKGROUND

2. Identifying the jurisdictional nature and regulatory treatment of ISP-bound communications requires us to determine how Internet traffic fits within our existing regulatory framework. We begin, therefore, with a brief description of relevant terminology and technology. We then turn to the specific matter of LEC delivery of ISP-bound communications.

A. The Internet and ISPs.

3. The Internet is an international network of interconnected computers enabling millions of people to communicate with one another and to access vast amounts of information from around the world.[3] The Internet functions by splitting up information into "small chunks or 'packets' that are individually routed . . . to their destination."[4] With packet-switching, "even two packets from the same message may travel over different physical paths through the network . . . which enables users to invoke multiple Internet services simultaneously, and to access information with no knowledge of the physical location of the service where the information resides."[5]

4. An ISP is an entity that provides its customers the ability to obtain online information through the Internet. ISPs purchase analog and digital lines from local exchange carriers to connect to their dial-in subscribers.[6] Under one typical arrangement, an ISP customer dials a seven-digit number to reach the ISP server in the same

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[3] 47 U.S.C. § 230; *see also Reno v. American Civil Liberties Union*, 117 S. Ct. 2329, 2334 (1997).

[4] *Universal Service Report to Congress*, 13 FCC Rcd at 11531, 11532.

[5] *Id.*

[6] *Id.* at 11532.

local calling area. The ISP, in turn, combines "computer processing, information storage, protocol conversion, and routing with transmission to enable users to access Internet content and services."[7] Under this arrangement, the end user generally pays the LEC a flat monthly fee for use of the local exchange network and generally pays the ISP a flat, monthly fee for Internet access.[8] The ISP typically purchases business lines from a LEC, for which it pays a flat monthly fee that allows unlimited incoming calls.

5. Although the Commission has recognized that enhanced service providers (ESPs), including ISPs, use interstate access services,[9] since 1983 it has exempted ESPs from the payment of certain interstate access

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[7] *Id.* at 11531.

[8] The Commission has acknowledged the significance of end users being able to place local, rather than toll, calls to ISPs, in analyzing, among other things, universal service issues. *See, e.g.*, Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd 8776, 9142-43, 9159, 9160 (1997) (*Universal Service Order*); *Universal Service Report to Congress*, 13 FCC Rcd at 11541-42.

[9] *See, e.g.*, MTS and WATS Market Structure, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 711 (1983) (*MTS/WATS Market Structure Order*) ("[a]mong the variety of users of access service are . . . enhanced service providers"); Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 3 FCC Rcd 2631 (1988) (*ESP Exemption Order*) (referring to "certain classes of exchange access users, including enhanced service providers"); Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 2 FCC Rcd 4305, 4306 (1987) (ESPs, "like facilities-based interexchange carriers and resellers, use the local network to provide interstate services"); *Access Charge Reform Order*, 12 FCC Rcd at 16131-32 (information service providers "may use incumbent LEC facilities to originate and terminate interstate calls").

charges.[10] Pursuant to this exemption, ESPs are treated as end users for purposes of assessing access charges, and the Commission permits ESPs to purchase their links to the public switched telephone network (PSTN) through intrastate business tariffs rather than through interstate access tariffs.[11] Thus, ESPs generally pay local business rates and interstate subscriber line charges for their switched access connections to local exchange company central offices.[12] In addition, incumbent LEC expenses and revenue associated with ISP-bound traffic traditionally have been characterized as intrastate for separations purposes.[13] ESPs also pay the special access surcharge when purchasing special access lines under the same conditions as those applicable to end users.[14] In the

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[10] The exemption was adopted at the inception of the interstate access charge regime to protect certain users of access services, such as ESPs, that had been paying the generally much lower business service rates from the rate shock that would result from immediate imposition of carrier access charges. *See MTS/WATS Market Structure* Order, 97 FCC 2d at 715.

[11] Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 3 FCC Rcd 2631, 2635 n.8, 2637 n.53 (1988) (*ESP Exemption Order*).

[12] *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. The subscriber line charge (SLC) is an access charge imposed on end users to recover at least a portion of the cost of the interstate portion of LEC facilities used to link each end user to the public switched telephone network (PSTN).

[13] Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket No. 89-79, Notice of Proposed Rulemaking, 4 FCC Rcd. 3983, 3987-88 (1989).

[14] *See* 47 C.F.R. § 69.5(a) ("End user charges shall be computed and assessed upon public end users, and upon providers of public telephones. . . ."); *see also* 47 C.F.R. § 69.5(c) ("Special access surcharges shall be assessed upon users of exchange facilities that interconnect these facilities with means of interstate or foreign tele-

Access Charge Reform Order, the Commission decided to maintain the existing pricing structure pursuant to which ESPs are treated as end users for the purpose of applying access charges.[15] Thus, the Commission continues to discharge its interstate regulatory obligations by treating ISP-bound traffic as though it were local.

6. The Internet provides citizens of the United States with the ability to communicate across state and national borders in ways undreamed of only a few years ago. The Internet also is developing into a powerful instrumentality of interstate commerce. In 1997, we decided that retaining the ESP exemption would avoid disrupting the still-evolving information services industry and advance the goals of the 1996 Act to "preserve the vibrant and competitive free market that presently exists for the

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communications to the extent that carrier's carrier charges are not assessed upon such interconnected usage."). *See also* 47 C.F.R. § 69.2(m) (End user means "any customer of an interstate or foreign telecommunications service that is not a carrier except that a carrier other than a telephone company shall be deemed to be an 'end user' when such carrier uses a telecommunications service for administrative purposes and a person or entity that offers telecommunications services exclusively as a reseller shall be deemed to be an 'end user' if all resale transmissions offered by such reseller originate on the premises of such reseller.").

[15] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34. On August 19, 1998, the U.S. Court of Appeals for the Eighth Circuit affirmed the Commission's *Access Charge Reform Order*. Specifically, the court found that the Commission's decision to exempt information services providers from the application of interstate access charges (other than SLCs) was consistent with past precedent, did not unreasonably discriminate in favor of ISPs, did not constitute an unlawful abdication of the Commission's regulatory authority in favor of the states, and did not deprive incumbents of the ability to recover their pertinent costs. *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523, 542 (8th Cir. 1998).

Internet and other interactive computer services."[16] This Congressional mandate underscores the obligation and commitment of this Commission to foster and preserve the dynamic market for Internet-related services. We emphasize the strong federal interest in ensuring that regulation does nothing to impede the growth of the Internet—which has flourished to date under our "hands off" regulatory approach—or the development of competition. We are mindful of the need to address the jurisdictional question at issue here, and the effect the jurisdictional determination may have on inter-carrier compensation for ISP-bound traffic, in a manner that promotes efficient entry by providers of both local telephone and Internet access services, and that, by the same token, does not encourage inefficient entry.

B. **Incumbent LEC and CLEC Delivery of ISP-Bound Traffic.**

7. Section 251(b)(5) of the Act requires all LECs "to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[17] In the *Local Competition Order*, this Commission construed this provision to apply only to the transport and termination of "local telecommunications traffic."[18] In order to

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[16] *Access Charge Reform Order*, 12 FCC Rcd at 16134. *See also* 47 U.S.C. § 230(b)(2) ("It is the policy of the United States to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.").

[17] 47 U.S.C. § 251(b)(5).

[18] *See* 47 C.F.R. § 51.701; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket Nos. 96-98, 95-185, 11 FCC Rcd 15499, 16013 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub*

determine what compensation is due when two carriers collaborate to deliver a call to an ISP, we must determine as a threshold matter whether this is interstate or intrastate traffic. In general, an originating LEC end user's call to an ISP served by another LEC is carried (1) by the originating LEC from the end user to the point of interconnection (POI) with the LEC serving the ISP; (2) by the LEC serving the ISP from the LEC-LEC POI to the ISP's local server; and (3) from the ISP's local server to a computer that the originating LEC end user desires to reach via the Internet. If these calls terminate at the ISP's local server (where another (packet-switched) "call" begins), as many CLECs contend, then they are

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nom. Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999); *Order on Reconsideration*, 11 FCC Rcd 13042 (1996); *Second Order on Reconsideration*, 11 FCC Rcd 19738 (1996); *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, 12 FCC Rcd 12460 (1997); *further recon. pending.* State commissions that considered this issue reached the same conclusion. *See, e.g.*, Petition of the Southern New England Tel. Co. for a Declaratory Ruling Concerning Internet Servs. Provider Traffic, Docket No. 97-05-22, Decision, at 9 (Conn. Comm'n September 17, 1997); *Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service*, R.95-04-04, Decision 98-10-057, at 7 (Cal. Comm'n October 28, 1998); Southwestern Bell Tel. Co. v. Public Util. Comm'n of Texas, MO-98-CA-43, slip op. at 7 (W.D. Tex. June 16, 1998). Section 251 of the Act makes clear that interstate traffic remains subject to the Commission's jurisdiction under section 201. *See* 47 U.S.C. § 251(i) ("Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."). *See also CompTel*, 117 F.3d at 1075 (Commission acted within its jurisdiction in allowing incumbent LECs to collect, on an interim basis, access charges for interstate calls traversing the incumbent LECs' local switches for which the interconnecting carriers pay unbundled local switching element charges); 47 U.S.C. §152(a) (Commission has jurisdiction over "all interstate and foreign communications by wire").

intrastate calls, and LECs serving ISPs are entitled to reciprocal compensation for the "transport and termination" of this traffic. If, however, these calls do not terminate locally, incumbent LECs argue, then LECs serving ISPs are not entitled to reciprocal compensation under section 251(b)(5).

8. CLECs argue that, because section 251(b)(5) of the Act refers to the duty to establish reciprocal compensation arrangements for the "transport and termination of telecommunications,"[19] a transmission "terminates" for reciprocal compensation purposes when it ceases to be "telecommunications."[20] "Telecommunications" is defined in the Act as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[21] CLECs contend that, under this definition, Internet service is not "telecommunications" and that the "telecommunications" component of Internet traffic terminates at the ISP's local server. In addition, CLECs and ISPs argue that, given that ESPs are exempt from paying certain interstate access charges[22] and that, as a result, the PSTN links serving ESPs are treated as intrastate under the separations regime, the services that CLECs provide for ISPs must

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[19] 47 U.S.C. § 251(b)(5) (emphasis added).

[20] *See, e.g.*, RCN Telecom Services (RCN) Comments at 6; Teleport Communications Group Inc. (TCG) Comments at 4-5; WorldCom, Inc. Comments at 8-9. Citations to parties' comments in this Declaratory Ruling and Notice of Proposed Rulemaking refer to comments filed in response to the *ALTS Letter Notice*.

[21] 47 U.S.C. § 153(43).

[22] We discuss the ESP exemption, *supra*.

be deemed local.[23] Incumbent LECs contend, however, that the "telecommunications" terminate not at the ISP's local server, but at the Internet site accessed by the end user, in which case these are interstate calls for which, they argue, no reciprocal compensation is due.[24]

III. DISCUSSION

9. The Commission has no rule governing inter-carrier compensation for ISP-bound traffic. Generally speaking, when a call is completed by two (or more) interconnecting carriers, the carriers are compensated for carrying that traffic through either reciprocal compensation or access charges. When two carriers jointly provide interstate access (*e.g.*, by delivering a call to an interexchange carrier (IXC)), the carriers will share access revenues received from the inter-state service provider. Conversely, when two carriers collaborate to complete a local call, the originating carrier is compensated by its end user and the terminating carrier is entitled to reciprocal compensation pursuant to section 251(b)(5) of the Act. Until now, however, it has been unclear whether or how the access charge regime or reciprocal compensation applies when two interconnecting carriers deliver traffic to an ISP. As explained above, under the ESP exemption, LECs may not impose access charges on ISPs; therefore, there are no access revenues for inter-

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[23] *See, e.g.*, American Communications Services, Inc. (ACSI) Comments at 5; Adelphia Communications Corporation (Adelphia), et al., Comments at 12-13; ALTS Letter at 6-7; ALTS Reply at 2, 13; Cox Communications, Inc. (Cox) Comments at 5; America Online, Inc. (AOL) Comments at 7-8; AT&T Corp. Comments at 4.

[24] *See, e.g.*, Ameritech Operating Cos. (Ameritech) Comments at 13; BellSouth Corporation (BellSouth) Reply at 4-6; Southwestern Bell Tel. Co., Pacific Bell, Nevada Bell (SBC) Reply at 5; United States Telephone Association (USTA) Comments at 5-6.

connecting carriers to share. Moreover, the Commission has directed states to treat ISP traffic as if it were local, by permitting ISPs to purchase their PSTN links through local business tariffs. As a result, and because the Commission had not addressed intercarrier compensation under these circumstances, parties negotiating interconnection agreements and the state commissions charged with interpreting them were left to determine as a matter of first impression how interconnecting carriers should be compensated for delivering traffic to ISPs, leading to the present dispute.

A. Jurisdictional Nature of Incumbent LEC and CLEC Delivery of ISP-Bound Traffic.

10. As many incumbent LECs properly note,[25] the Commission traditionally has determined the jurisdictional nature of communications by the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers. In *BellSouth MemoryCall*, for example, the Commission considered the jurisdictional nature of traffic that consisted of an incoming interstate transmission (call) to the switch serving a voice mail subscriber and an intrastate transmission of that message from that switch to the voice mail apparatus.[26] The Commission determined that the entire transmission constituted one interstate call, because "there is a continuous path of communications across state lines between the caller and the voice mail ser-

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[25] *See, e.g.*, Ameritech Comments at 13; BellSouth Reply at 4-6; SBC Reply at 5; USTA Comments at 5-6.

[26] Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation, 7 FCC Rcd 1619 (1992) (*BellSouth MemoryCall*).

vice."[27] The Commission's jurisdictional determination did not turn on the common carrier status of either the provider or the services at issue;[28] *BellSouth MemoryCall* is not, therefore, distinguishable on the grounds that ISPs are not common carriers.

11. Similarly, in *Teleconnect*, the Bureau examined whether a call using Teleconnect's "All-Call America" (ACA) service, a nationwide 800 travel service that uses AT&T's Megacom 800 service, is a single, end-to-end call.[29] Generally, an ACA call is initiated by an end user from a common line open end; the call is routed through a LEC to an AT&T Megacom line, and is then transferred from AT&T to Teleconnect by another LEC.[30] At that point, Teleconnect routes the call through the LEC to the end user being called.[31] The Bureau rejected the argument that the (ACA) 800 call used to connect to an interexchange carrier's (IXC) switch was a separate and distinct call from the call that was placed from that switch.[32] The Commission affirmed, noting that "both court and Commission decisions have considered the end-to-end nature of the communications more significant than the facilities used to complete such communications. According to these precedents, we regulate an interstate wire communications under the Communications Act

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[27] *Id.* at 1620.

[28] *Id.* at 1621-22. Indeed, the Commission expressly noted that, although BellSouth's "voice mail service is an enhanced service, that fact does not limit our authority to preempt." *Id.* at 1622 n.44.

[29] *Teleconnect Co. v. Bell Telephone Co. of Penn.*, E-88-83, 10 FCC Rcd 1626 (1995) (*Teleconnect*), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997).

[30] *Id.* at 1627.

[31] *Id.* at 1627-28.

[32] *Id.* at 1626.

from its inception to its completion."[33] The Commission concluded that "an interstate communication does not end at an intermediate switch.... The interstate communication itself extends from the inception of a call to its completion, regardless of any intermediate facilities."[34] In addition, in *Southwestern Bell Telephone Company*, the Commission rejected the argument that "a credit card call should be treated for jurisdictional purposes as two calls: one from the card user to the interexchange carrier's switch, and another from the switch to the called party" and concluded that "switching at the credit card switch is an intermediate step in a single end-to-end communication."[35]

12. Consistent with these precedents,[36] we conclude, as explained further below, that the communications at issue here do not terminate at the ISP's local server, as

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[33] *Id.* at 1629 (citing *NARUC v. FCC*, 746 F.2d 1492, 1498 (D.C. Cir. 1984) (concluding that a physically intrastate in-WATS line, used to terminate an end-to-end interstate communication, is an interstate facility subject to Commission regulation)). *See also United States v. AT&T*, 57 F. Supp. 451, 454 (S.D.N.Y. 1944) (the Act contemplates the regulation of interstate wire communication from its inception to its completion), *aff'd sub nom. Hotel Astor v. United States*, 325 U.S. 837 (1945); *New York Telephone Co.*, 76 FCC 2d 349, 352-53 (1980) (physically intrastate foreign exchange facilities used to carry interconnected interstate traffic are subject to federal jurisdiction).

[34] *Teleconnect*, 10 FCC Rcd at 1629.

[35] In the Matter of Southwestern Bell Tel. Co., CC Docket No. 88-180, Order Designating Issues for Investigation, 3 FCC Rcd 2339, 2341 (1988) (*Southwestern Bell Tel. Co.*).

[36] Although the cited cases involve interexchange carriers rather than ISPs, and the Commission has observed that "it is not clear that ISPs use the public switched network in a manner analogous to IXCs," *Access Charge Reform Order*, 12 FCC Rcd at 16133, the Commission's observation does not affect the jurisdictional analysis.

CLECs and ISPs contend,[37] but continue to the ultimate destination or destinations, specifically at a Internet website that is often located in another state.[38] The fact that the facilities and apparatus used to deliver traffic to the ISP's local servers may be located within a single state does not affect our jurisdiction. As the Commission stated in *BellSouth MemoryCall*, "this Commission has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with the origination and termination of interstate calls."[39] Indeed, in the vast majority of cases, the facilities that incumbent LECs use to provide interstate access are located entirely within one state.[40] Thus, we reject MCI WorldCom's assertion that the LEC facilities used to deliver traffic to ISPs must cross state boundaries for such traffic to be classified as interstate.[41]

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[37] *See, e.g.*, ACSI Comments at 5; Adelphia, et al., Comments at 12-13; ALTS Letter at 6-7; Cox Comments at 5.

[38] This conclusion is fully consistent with *BellSouth MemoryCall*. Although MCI WorldCom relies on *BellSouth MemoryCall* to support its argument that the ISP is the relevant endpoint for purposes of the jurisdictional analysis (*see* Letter from Richard S. Whitt, Director—Federal Affairs/Counsel, MCI WorldCom, Inc., to Magalie R. Salas, Secretary, FCC (October 2, 1998)), there, as here, the Commission analyzed the communication from its inception to the "transmission's ultimate destination." *BellSouth MemoryCall*, 7 FCC Rcd at 1621.

[39] *BellSouth MemoryCall*, 7 FCC Rcd at 1621.

[40] *See Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, 360 (1986).

[41] *See* Letter from Richard S. Whitt, Director—Federal Affairs/Counsel, MCI WorldCom, Inc., to Magalie R. Salas, Secretary, FCC (October 19, 1998) (*MCI WorldCom Ex Parte*). For this reason, we also reject CLEC arguments that provision of such services by a Bell Operating Company (BOC) violates section 271 of the Act unless the BOC has received authorization to provide in-region InterLATA ser-

13. We disagree with those commenters that argue that, for jurisdictional purposes, ISP-bound traffic must be separated into two components: an intrastate telecommunications service, provided in this instance by one or more LECs, and an interstate information service, provided by the ISP.[42] As discussed above, the Commission analyzes the totality of the communication when determining the jurisdictional nature of a communication.[43] The Commission previously has distinguished between the "telecommunications services component" and the "information services component" of end-to-end Internet access for purposes of determining which entities are required to contribute to universal service.[44]

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vice. *See, e.g., MCI WorldCom Ex Parte* at 4. Section 271 does not bar BOC provision of interstate access services, such as interLATA information access. *See* Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket No. 96-149, 11 FCC Rcd 21905, 21962-63 (*Non-Accounting Safeguards Order*) ("When a BOC is neither providing nor reselling the interLATA transmission component of an information service that may be accessed across LATA boundaries, the statute does not require that service to be provided through a section 272 separate affiliate.").

[42] *See, e.g.*, RCN Comments at 6; TCG Comments at 4-5; WorldCom Comments at 8-9.

[43] *See United States v. AT&T*, 57 F. Supp. 451, 453-55 (S.D.N.Y. 1944), *aff'd*, 325 U.S. 837 (1945).

[44] *Universal Service Order*, 12 FCC Rcd at 9179-81. We disagree with MCI WorldCom's claim that the Commission determined in the *Universal Service Order* that there are two distinct transmissions when an end user contacts the Internet. *MCI WorldCom Ex Parte* at 4. In that order, the Commission discussed various "connections" involved with Internet access but in no way implied that any "transmission" or "traffic" terminated or originated at any intermediate point. *See Universal Service Order*, 12 FCC Rcd at 9180. As discussed, *supra*, MCI WorldCom's similar assertions regarding the

Although the Commission concluded that ISPs do not appear to offer "telecommunications service" and thus are not "telecommunications carriers" that must contribute to the Universal Service Fund,[45] it has never found that "telecommunications" end where "enhanced" service begins. To the contrary, in the context of open network architecture (ONA) elements, for example, the Commission stated that "an otherwise interstate basic service . . . does not lose its character as such simply because it is being used as a component in the provision of a[n enhanced] service that is not subject to Title II."[46] The 1996 Act is consistent with this approach. For example, as amended by the 1996 Act, Section 3(20) of the Communications Act defines "information services" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making

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Non-Accounting Safeguards Order are equally unpersuasive. *MCI WorldCom Ex Parte* at 4.

[45] *Id.* at 9180. We confirmed this view in the *Universal Service Report to Congress*. *Universal Service Report to Congress* at 13 FCC Rcd 11522-23.

[46] *See* Filing and Review of Open Network Architecture Plans, 4 FCC Rcd 1, 141 (1988) ("when an enhanced service is interstate (that is, when it involves communications or transmissions between points in different states on an end-to-end basis), the underlying basic services are subject to Title II regulation"), *aff'd sub nom. People of State of Cal. v. FCC*, 3 F.3d 1505 (9th Cir. 1993). *See, e.g.*, Amendment of Section 64.702 of the Commission's Rules and Regulations, 2 FCC Rcd 3072, 3080 (1987) ("carriers must provide efficient nondiscriminatory access to the basic service facilities necessary to support their competitors' enhanced services"); *vacated on other grounds sub nom. People of State of Cal. v. FCC*, 905 F.2d 1217 (9th Cir. 1990). *See also BellSouth MemoryCall*, 7 FCC Rcd at 1621 (rejecting "two call" argument as applied to interstate call to voice mail apparatus, even though voice mail is an enhanced service).

available information via telecommunications."[47] This definition recognizes the inseparability, for purposes of jurisdictional analysis, of the information service and the underlying telecommunications. Although it concluded in the *Universal Service Report to Congress* that ISPs do not provide "telecommunications" as defined in the 1996 Act,[48] the Commission reiterated the traditional analysis that ESPs enhance the underlying telecommunications service.[49] Thus, we analyze ISP traffic for jurisdictional purposes as a continuous transmission from the end user to a distant Internet site.

14. Some CLECs note that the language of section 252(d)(2) provides for the recovery of the costs of transporting and terminating a "call."[50] Although the 1996 Act does not define the term "call," these CLECs argue that it is used in the 1996 Act in a manner that implies a circuit-switched connection between two telephone numbers.[51] For example, Adelphia contends that a "call" takes place when two stations on the PSTN are connected to each other.[52] A call "terminates," according to Adelphia, when one station on the PSTN dials another station,

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[47] 47 U.S.C. § 153(20) (emphasis added); *see also* 47 C.F.R. § 64.702(a) (enhanced services are provided "over common carrier transmission facilities used in interstate communications").

[48] *Universal Service Report to Congress*, 13 FCC Rcd at 11536-40. *See also Universal Service Order*, 12 FCC Rcd at 9180 n.2023.

[49] *See Universal Service Report to Congress*, 13 FCC Rcd at 11540. *See also Universal Service Order* 12 FCC Rcd at 9180 n.2023 (referencing Amendment of Section 64.702 of the Commission's Rules and Regulations, 2 FCC Rcd 3072, 3080 (1987)).

[50] 47 U.S.C. § 252(d)(2). *See, e.g.*, Adelphia, et al., Comments at 15.

[51] *See, e.g.*, Adelphia, et al., Comments at 15-20; Adelphia, et al., Reply at 5, 9-10, TCG Comments at 3-4; WorldCom Comments at 6-7.

[52] *See, e.g.*, Adelphia, et al., Comments at 15-16.

and the second station answers.[53] Under this view, the "call" associated with Internet traffic ends at the ISP's local premises.[54]

15. We find that this argument is inconsistent with Commission precedent, discussed above, holding that communications should be analyzed on an end-to-end basis, rather than by breaking the transmission into component parts. The examples cited by CLECs[55] to support the argument that calls end at the called number are not dispositive. The statutory sections upon which they rely were written to apply to specific situations, all of which, as far as we can tell, involve traditional telephony connections between two called numbers, as opposed to the novel circumstance of Internet traffic.[56]

16. Nor are we are persuaded by CLEC arguments that, because the Commission has treated ISPs as end users for purposes of the ESP exemption, an Internet call must terminate at the ISP's point of presence.[57] The Commission traditionally has characterized the link from an end user to an ESP as an interstate access service.[58] In the *MTS/WATS Market Structure Order*, for instance, the Commission concluded that ESPs are "among a

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[53] *Id.*

[54] *Id.*

[55] *Id.* at 15-16, 19-20; Adelphia, et al., Reply at 18 n.32.

[56] *See, e.g.*, 47 U.S.C. §§ 222(d)(3), 223(a)(1), 271(c)(2)(B)(x), and 271(j).

[57] *See, e.g.*, ACSI Comments at 5; Adelphia, et al., Comments at 12-13; ALTS Letter at 6-7; ALTS Reply at 2, 13; Cox Comments at 5; AOL Comments at 7-8; AT&T Comments at 4.

[58] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 715; Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305 (1987).

variety of users of access service" in that they "obtain local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location and, commonly, another location in the exchange area."[59] The fact that ESPs are exempt from access charges and purchase their PSTN links through local tariffs does not transform the nature of traffic routed to ESPs. That the Commission exempted ESPs from access charges indicates its understanding that ESPs in fact use interstate access service; otherwise, the exemption would not be necessary.[60] We emphasize that the Commission's decision to treat ISPs as end users for access charge purposes and, hence, to treat ISP-bound traffic as local, does not affect the Commission's ability to exercise jurisdiction over such traffic.[61]

17. CLECs also argue that the traffic they deliver to ISPs must be deemed either "telephone exchange service"[62] or "exchange access."[63] They contend that ISP

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[59] *MTS/WATS Market Structure Order*, 97 FCC 2d at 860; *see also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305.

[60] *See, e.g.*, *MTS/WATS Market Structure Order*, 97 FCC 2d at 860. *See also* Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, 11 FCC Rcd 21354 at 21478 ("although ESPs may use incumbent LEC facilities to originate and terminate interstate calls, ESPs should not be required to pay interstate access charges") (emphasis added).

[61] Indeed, the Eighth Circuit found that "the Commission has appropriately exercised its discretion to require an ISP to pay intrastate charges for its line and to pay the SLC . . . , but not to pay the per-minute interstate access charge." *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d at 543 (emphasis added).

[62] "Telephone exchange service" means "(A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to sub-

traffic cannot be "exchange access," because neither LECs nor CLECs assess toll charges for the service. CLEC delivery of ISP traffic is, therefore, according to CLECs, "telephone exchange service," a form of local telecommunications for which reciprocal compensation is due.[64] As discussed above, however, the Commission consistently has characterized ESPs as "users of access service" but has treated them as end users for pricing purposes.[65] Thus, we are unpersuaded by this argument.

18. Having concluded that the jurisdictional nature of ISP-bound traffic is determined by the nature of the end-to-end transmission between an end user and the Internet, we now must determine whether that transmission constitutes interstate telecommunications. Section 2(a) of the Act grants the Commission jurisdiction

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scribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service." 47 U.S.C. § 153(47).

[63] "Exchange access" is defined as "the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services." 47 U.S.C. §153(16). "Telephone toll services" is defined as "telephone service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service." 47 U.S.C. § 153(48).

[64] *See, e.g.*, Adelphia, et al., Reply at 5-9.

[65] *MTS/WATS Market Structure Order*, 97 FCC 2d at 860; *see also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305 (1987). *See also* 47 C.F.R. § 69.2(b) (defining "access service" as "services and facilities provided for the origination or termination of any interstate or foreign telecommunications").

over "all interstate and foreign communication by wire."[66] Traffic is deemed interstate "when the communication or transmission originates in any state, territory, possession of the United States, or the District of Columbia and terminates in another state, territory, possession, or the District of Columbia."[67] In a conventional circuit-switched network, a call that originates and terminates in a single state is jurisdictionally intrastate, and a call that originates in one state and terminates in a different state (or country) is jurisdictionally interstate. The jurisdictional analysis is less straightforward for the packet-switched network environment of the Internet.[68] An Internet communication does not necessarily have a point of "termination" in the traditional sense. An Internet user typically communicates with more than one destination point during a single Internet call, or "session," and may do so either sequentially or simultaneously. In a single Internet communication, an Internet user may, for example, access websites that reside on servers in various states or foreign countries, communicate directly with another Internet user, or chat online with a group of Internet users located in the same local exchange or in another country.[69] Further complicating the matter of identifying the geographical destinations of Internet traffic is that the contents of popular websites increasingly are being stored in multiple servers throughout the Internet, based on "caching" or website "mirroring" tech-

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[66] 47 U.S.C. § 152(a).

[67] *Universal Service Report to Congress*, 13 FCC Rcd at 11555.

[68] *See, e.g.*, Kevin Werbach, Digital Tornado: The Internet and Telecommunications Policy, OPP Working Paper No. 29, at 45 (Mar. 1997) (*Digital Tornado*).

[69] *See, e.g., Digital Tornado* at 45. *See also* Adelphia, et al., Reply at 11 n.21.

niques.[70] After reviewing the record, we conclude that, although some Internet traffic is intrastate, a substantial portion of Internet traffic involves accessing interstate or foreign websites.[71]

19. Although ISP-bound traffic is jurisdictionally mixed, incumbent LECs argue that it is not technically possible to separate the intrastate and interstate ISP-bound traffic.[72] In the current absence of a federal rule governing inter-carrier compensation, however, we do not find it necessary to reach the question of whether such traffic is separable into intrastate and interstate traffic.[73]

20. Our determination that at least a substantial portion of dial-up ISP-bound traffic is interstate does not, however, alter the current ESP exemption. ESPs, including ISPs, continue to be entitled to purchase their PSTN links through intrastate (local) tariffs rather than

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[70] *See, e.g., MCI WorldCom Ex Parte* at 7.

[71] *See, e.g.*, Adelphia, et al., Comments at 22; Letter from Edward D. Young, Senior Vice President & Deputy General Counsel for Bell Atlantic, and Thomas J. Tauke, Senior Vice President—Government Relations for Bell Atlantic, to Hon. William E. Kennard, Chairman, FCC (July 1, 1998) at Att. 2; Compuserve Comments at 4; Letter from B. Jeannie Fry, Director of Federal Regulatory Affairs, SBC Communications, Inc., to Magalie R. Salas, Secretary, FCC (May 13, 1998) Att. at 7; WorldCom Reply at 8-9.

[72] Even if it is technically impossible to separate the intrastate and interstate ISP traffic, it may be possible for LECs to determine whether dial-up traffic is in fact destined for an ISP.

[73] We note that in Section IV, *infra*, we seek comment on the separability of such traffic and whether the Commission should exercise exclusive jurisdiction over intercarrier compensation for all ISP-bound traffic.

through interstate access tariffs.[74] Nor, as we discuss below, is it dispositive of interconnection disputes currently before state commissions.

B. Inter-Carrier Compensation for Delivery of ISP-Bound Traffic.

21. We find no reason to interfere with state commission findings as to whether reciprocal compensation provisions of interconnection agreements apply to ISP-bound traffic, pending adoption of a rule establishing an appropriate interstate compensation mechanism. We seek comment on such a rule in Section IV, below.

22. Currently, the Commission has no rule governing inter-carrier compensation for ISP-bound traffic. In the absence of such a rule, parties may voluntarily include this traffic within the scope of their interconnection agreements under sections 251 and 252 of the Act, even if these statutory provisions do not apply as a matter of law. Where parties have agreed to include this traffic within their section 251 and 252 interconnection agreements, they are bound by those agreements, as interpreted and enforced by the state commissions.

23. Although we determine, above, that ISP-bound traffic is largely interstate, parties nonetheless may have agreed to treat the traffic as subject to reciprocal compensation. The Commission's treatment of ESP traffic dates from 1983 when the Commission first adopted a different access regime for ESPs.[75] Since then, the Commission has maintained the ESP exemption, pursuant to

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[74] ESPs also have certain flat-rated interstate offerings available to them. *See, e.g.*, GTE Telephone Operating Cos. GTOC Transmittal No. 1148, CC Docket No. 98-79, FCC No. 98-292, Memorandum Opinion and Order (rel. October 30, 1998), *recon. pending*.

[75] *MTS/WATS Market Structure Order*, 97 FCC 2d at 715.

which it treats ESPs as end users under the access charge regime and permits them to purchase their links to the PSTN through intrastate local business tariffs rather than through interstate access tariffs. As such, the Commission discharged its interstate regulatory obligations through the application of local business tariffs. Thus, although recognizing that it was interstate access, the Commission has treated ISP-bound traffic as though it were local. In addition, incumbent LECs have characterized expenses and revenues associated with ISP-bound traffic as intrastate for separations purposes.[76]

24. Against this backdrop, and in the absence of any contrary Commission rule, parties entering into interconnection agreements may reasonably have agreed, for the purposes of determining whether reciprocal compensation should apply to ISP-bound traffic, that such traffic should be treated in the same manner as local traffic. When construing the parties' agreements to determine whether the parties so agreed, state commissions have the opportunity to consider all the relevant facts, including the negotiation of the agreements in the context of this Commission's longstanding policy of treating this traffic as local, and the conduct of the parties pursuant to those agreements. For example, it may be appropriate for state commissions to consider such factors as whether incumbent LECs serving ESPs (including ISPs) have done so out of intrastate or interstate tariffs; whether

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[76] Not all incumbent LECs characterize Internet traffic as intrastate traffic for separations purposes. In January, 1998, SBC indicated that it planned to allocate 100 percent of the costs associated with Internet traffic, which it previously had classified as local, to the interstate jurisdiction. *See* Letter from B. Jeannie Fry, Director of Federal Regulatory Affairs, SBC Communications., Inc., to Ken Moran, Chief, Accounting and Audits Division, FCC (Jan. 20, 1998).

revenues associated with those services were counted as intrastate or interstate revenues; whether there is evidence that incumbent LECs or CLECs made any effort to meter this traffic or otherwise segregate it from local traffic, particularly for the purpose of billing one another for reciprocal compensation; whether, in jurisdictions where incumbent LECs bill their end users by message units, incumbent LECs have included calls to ISPs in local telephone charges; and whether, if ISP traffic is not treated as local and subject to reciprocal compensation, incumbent LECs and CLECs would be compensated for this traffic. These factors are illustrative only; state commissions, not this Commission, are the arbiters of what factors are relevant in ascertaining the parties' intentions. Nothing in this Declaratory Ruling, therefore, necessarily should be construed to question any determination a state commission has made, or may make in the future, that parties have agreed to treat ISP-bound traffic as local traffic under existing interconnection agreements.[77] Finally, we note that issues regarding whether an entity is properly certified as a LEC if it

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[77] This analysis is not inconsistent with our conclusion in the *Local Competition Order* that section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within state-defined local calling areas. *Local Competition Order*, 11 FCC Rcd. at 16013. In so construing the statutory obligation, we did not preclude parties from agreeing to include interstate traffic (or non-local intrastate traffic) within the scope of their interconnection agreements, so long as no Commission rules were otherwise violated. *See* 47 U.S.C. § 252(a)(1) (parties may negotiate and enter into a binding agreement without regard to the standards set forth in section 251(b) and (c)).

serves only or predominantly ISPs are matters of state jurisdiction.[78]

25. Even where parties to interconnection agreements do not voluntarily agree on an inter-carrier compensation mechanism for ISP-bound traffic, state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic. The passage of the 1996 Act raised the novel issue of the applicability of its local competition provisions[79] to the issue of inter-carrier compensation for ISP-bound traffic. Section 252 imposes upon state commissions the statutory duty to approve voluntarily-negotiated interconnection agreements and to arbitrate interconnection disputes. As we observed in the *Local Competition Order*, state commission authority over interconnection agreements pursuant to section 252

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[78] *See, e.g.*, Complaint of WorldCom Technologies, Inc. against New England Tel. and Tel. Co. for alleged breach of interconnection terms entered into under Section 251 and 252 of the Telecommunications Act of 1996, D.T.E. 97-116, at 13 (Mass. Comm'n October 26, 1998) (requesting information from parties regarding whether certain CLECs have been or are established solely (or predominantly) for the purpose of delivering traffic to ISPs, particularly ISPs affiliated with the CLECs in question, and stating that these facts might affect such CLECs' regulatory status); Letter from B. Jeannie Fry, Director of Federal Regulatory Affairs, SBC Communications, Inc., to Magalie R. Salas, Secretary, FCC (May 13, 1998) at Tab 5 (carrier's webpage advertisement invites parties to offer "free internet access while getting paid for it"). We believe the state commissions are capable of assessing whether and to what extent these and other anomalous practices are inconsistent with the statutory scheme (*e.g.*, definition of a carrier) and thereby outside the scope of any determination regarding inter-carrier compensation.

[79] *See* 47 U.S.C. §§ 251, 252.

"extends to both interstate and intrastate matters."[80] Thus the mere fact that ISP-bound traffic is largely interstate does not necessarily remove it from the section 251/252 negotiation and arbitration process.[81] However, any such arbitration must be consistent with governing federal law.[82] While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic.

26. Some CLECs construe our rules treating ISPs as end users for purposes of interstate access charges as requiring the payment of reciprocal compensation for this traffic.[83] Incumbent LECs contend, however, that our rules preclude the imposition of reciprocal compensation obligations to interstate traffic and that, pursuant to the ESP exemption, LECs carrying ISP-bound traffic are compensated by their end user customers—the originating end user or the ISP.[84] Either of these options might

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[80] *Local Competition Order*, 11 FCC Rcd at 15544; *see also id.* at 15547 (sections 251 and 252 "address both interstate and intrastate aspects of interconnection, services, and access to unbundled network elements").

[81] *Id.*

[82] *Cf.* 47 U.S.C. § 251(i) ("Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201.").

[83] *See* note 26, *supra*, and accompanying text.

[84] *See, e.g.*, Letter from Gary L. Phillips, Director of Legal Affairs, Ameritech, to Magalie Salas, Secretary, FCC (November 20, 1998). Ameritech argues, *inter alia*, that the Commission held in the *Local Competition Order* that reciprocal compensation does not apply to the transport and termination of interstate traffic. *Id.*, Att. A, at 6. It further argues that Commission rules do in fact address inter-

be a reasonable extension of our rules, but the Commission has never applied either the ESP exemption or its rules regarding the joint provision of access to the situation where two carriers collaborate to deliver traffic to an ISP. As we stated previously, the Commission currently has no rule addressing the specific issue of inter-carrier compensation for ISP-bound traffic.[86] In the absence of a federal rule, state commissions that have had to fulfill their statutory obligation under section 252 to resolve interconnection disputes between incumbent LECs and CLECs have had no choice but to establish an inter-carrier compensation mechanism and to decide whether and under what circumstances to require the payment of reciprocal compensation. Although reciprocal compensation is mandated under section 251(b)(5) only for the transport and termination of local traffic,[87] neither the statute nor our rules prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate in certain instances not addressed by section 251(b)(5), so long as there is no conflict with governing federal law.[87] A state commission's

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carrier compensation for ISP traffic. In the usual case, two LECs jointly providing interstate access service share access revenues; because the Commission exempts ISPs from the payment of access charges, however, LECs carrying ISP traffic are limited to revenues they collect from their end user customers. *Id.*, Att. A, at 7.

[86] We seek comment on an appropriate compensation mechanism in Section IV, below.

[87] *See* 47 C.F.R. 51.701(a); *Local Competition Order*, 11 FCC Rcd at 16013.

[87] As noted, section 251(b)(5) of the Act and our rules promulgated pursuant to that provision concern inter-carrier compensation for interconnected *local* telecommunications traffic. We conclude in this Declaratory Ruling, however, that ISP-bound traffic is non-local interstate traffic. Thus, the reciprocal compensation requirements of section 251(b)(5) of the Act and Section 51, Subpart H (Reciprocal

decision to impose reciprocal compensation obligations in an arbitration proceeding—or a subsequent state commission decision that those obligations encompass ISP-bound traffic—does not conflict with any Commission rule regarding ISP-bound traffic.[88] By the same token, in the absence of governing federal law, state commissions also are free not to require the payment of reciprocal compensation for this traffic and to adopt another compensation mechanism.

27. State commissions considering what effect, if any, this Declaratory Ruling has on their decisions as to whether reciprocal compensation provisions of interconnection agreements apply to ISP-bound traffic might conclude, depending on the bases of those decisions, that it is not necessary to re-visit those determinations. We recognize that our conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusion that reciprocal compensation is due to the extent that those conclusions are based on a finding that this traffic terminates at an ISP server, but nothing in this Declaratory Ruling precludes state commissions from determining, pursuant to contractual principles or other legal or equitable considerations, that reciprocal compensation is an appropriate interim inter-carrier compensation rule pending completion of the rulemaking we initiate below.

Compensation for Transport and Termination of Local Telecommunications Traffic) of the Commission's rules do not govern inter-carrier compensation for this traffic. As discussed, *supra*, in the absence a federal rule, state commissions have the authority under section 252 of the Act to determine inter-carrier compensation for ISP-bound traffic.

[88] As noted, in other contexts we have directed the states to treat such traffic as local. *See ESP Exemption Order*, 3 FCC Rcd 2631, 2635 n.8, 2637 n.53.

IV. Notice of Proposed Rulemaking (CC Docket No. 99-68)

A. Discussion.

28. We do not have an adequate record upon which to adopt a rule regarding inter-carrier compensation for ISP-bound traffic. We do believe, however, that adopting such a rule to govern prospective compensation would serve the public interest. As a general matter, we tentatively conclude that our rule should strongly reflect our judgment that commercial negotiations are the ideal means of establishing the terms of interconnection contracts. We seek comment on two alternative proposals for implementing such a regime. Until adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic. As discussed above, the Commission's holding that parties' agreements, as interpreted by state commissions, should be binding also applies to those state commissions that have not yet addressed the issue.

29. For the traffic at issue here, we tentatively conclude that a negotiation process, driven by market forces, is more likely to lead to efficient outcomes than are rates set by regulation. In addition, setting a rate by regulation appears unwise because the actual amounts, need for, and direction of inter-carrier compensation might reasonably vary depending on the underlying commercial relationships with the end user, and who ultimately pays for transmission between its location and the ISP.[89] We

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[89] When an end user effectively purchases a telecommunications-based service from more than one service provider, it can pay for the costs of the underlying telecommunications either directly to the telecommunications service provider, or indirectly through the other service provider, which in turn pays the telecommunications provider. Both sets of arrangements exist today.

acknowledge that, no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network. We believe that efficient rates for inter-carrier compensation for ISP-bound traffic are not likely to be based entirely on minute-of-use pricing structures. In particular, pure minute-of-use pricing structures are not likely to reflect accurately how costs are incurred for delivering ISP-bound traffic. For example, flat-rated pricing based on capacity may be more cost-based. Parties also might reasonably agree to rates that include a separate call set-up charge, coupled with very low per-minute rates. These economic characteristics of this traffic are likely to make voluntary agreements among the parties easier to reach. For these reasons, we propose that inter-carrier compensation rates for ISP-bound traffic be based on commercial negotiations undertaken as part of the broader interconnection negotiations between incumbent LECs and CLECs. We seek comment below on two alternative proposals to govern the negotiations with respect to ISP-bound traffic.

30. We tentatively conclude that, as a matter of federal policy, the inter-carrier compensation for this interstate telecommunications traffic should be governed prospectively by interconnection agreements negotiated and arbitrated under sections 251 and 252 of the Act. Resolution of failures to reach agreement on inter-carrier compensation for interstate ISP-bound traffic then would occur through arbitrations conducted by state commissions, which are appealable to federal district courts. As with other issues on which parties petition state commissions for arbitration under section 252 of the Act, if a state commission fails to act, the Commission will assume the responsibility of the state commission within 90 days of

being notified of such failure.[90] This proposal could help facilitate the policy goals set forth above by forcing the parties to hold a single set of negotiations regarding rates, terms, and conditions for interconnected traffic and to submit all disputes regarding interconnected traffic to a single arbitrator. We seek comment on this tentative conclusion.

31. We also seek comment on an alternative proposal that we adopt a set of federal rules governing intercarrier compensation for ISP-bound traffic pursuant to which parties would engage in negotiations concerning rates, terms, and conditions applicable to delivery of interstate ISP-bound traffic. These negotiations would commence on the effective date of the adopted rule but could proceed in tandem with broader interconnection negotiations between the parties. We realize, however, that the success of any negotiation over rates is likely to depend on the availability of the swift and certain resolution of disputes, and the structure of the resolution process. For example, the Commission, through delegation to the Common Carrier Bureau, might resolve such disputes, at the request of either party, through an arbitration-like process, following a discrete period of voluntary negotiation. We seek comment on how such an approach would operate procedurally and what costing standards the Commission might use in arbitrating disputes. We also seek comment on how this proposal compares with a broad interconnection negotiation in which most disputes are resolved by a state arbitrator but disputes regarding ISP-bound traffic are resolved through a federal arbitration-like process. We also seek comment on whether it is possible, as a technical matter, to segregate intrastate

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[90] 47 U.S.C. § 252(e)(5).

and interstate ISP-bound traffic and whether any federal rules we adopt should apply to all intrastate and interstate ISP-bound traffic.

32. We also seek comment on whether the Commission has the authority to establish an arbitration process that is final and binding and not subject to judicial review. For instance, we note that parties might agree to binding arbitration pursuant to the Administrative Dispute Resolution Act.[91] We seek comment on whether and how such a system should be implemented. In particular, we seek comment on the desirability of arbitration before an arbitrator selected by the parties, as provided by the Administrative Dispute Resolution Act, as opposed to a federal or state decision-maker.[92]

33. We also invite parties to submit alternative proposals for inter-carrier compensation for interstate ISP-bound traffic that will advance our policy goals in this area. For example, Ameritech has proposed basing inter-carrier compensation for ISP-bound traffic on sharing the incumbent LEC's revenue associated with the interconnected ISP-bound traffic.[93] We also request parties to comment on how any alternatives they propose will advance the Commission's goals of ensuring the broadest possible entry of efficient new competitors, eliminating incentives for inefficient entry and irrational pricing schemes, and providing to consumers as rapidly as possible the benefits of competition and emerging technologies.

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[91] Administrative Dispute Resolution Act, Pub. L. No. 101-552, 104 Stat. 2738, *codified at* 5 U.S.C. § 571 *et seq.*

[92] *See* 5 U.S.C. § 577.

[93] *See* Letter from Gary L. Phillips, Director of Legal Affairs, Ameritech, Inc., to Magalie R. Salas, Secretary, FCC (July 17, 1998).

34. We are aware that disputes may arise regarding various terms and conditions for inter-carrier compensation for ISP-bound traffic. Although many such disputes could be resolved through a negotiation and arbitration process, we seek comment on whether there are any issues under our two proposals above that we can and should address in the first instance through rules rather than through arbitration. We request parties to comment on the need for rules pertaining to such matters and, to the extent that parties believe that rules are appropriate, the substance and degree of specificity of such rules. We emphasize, however, that we do not seek comment on whether interstate access charges should be imposed on ESPs as part of this proceeding. We recently reaffirmed that exemption in the *Access Charge Reform Order*, and we do not reconsider it here.[94]

35. Pursuant to section 252(i) of the Act,[95] interconnection agreements often have clauses (often referred to as "most-favored nation" or "MFN" provisions) that allow parties to select, to varying degrees of specificity, provisions from other parties' interconnection agreements with that particular LEC. We understand that an arbitrator recently permitted a CLEC to exercise MFN rights to opt into an interconnection agreement that an incumbent LEC previously had negotiated with another CLEC.[96] That interconnection agreement, executed in July 1996, has a three-year term. The arbitrator concluded that the new CLEC was entitled to opt into the agreement for a new three-year term, thus raising the possi-

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[94] *Access Charge Reform Order*, 12 FCC Rcd at 16133.

[95] 47 U.S.C. § 252(i).

[96] *See* Letter from Michael E. Glover, Associate General Counsel, Bell Atlantic, to Magalie R. Salas, Secretary, FCC (October 28, 1998), at 2, Att. 3 at 6-8.

bility that the incumbent LEC might be subject to the obligations set forth in that agreement for an indeterminate length of time, without any opportunity for renegotiation, as successive CLECs opt into the agreement.[97] We seek comment, therefore, on whether and how section 252(i) and MFN rights affect parties' ability to negotiate or renegotiate terms of their interconnection agreements.

36. As discussed above, not all ISP-bound traffic is interstate. We seek comment on whether we should adopt rules for the interstate traffic that would coexist with state rules governing the intrastate traffic, or whether it is too difficult or inefficient to separate intrastate ISP-bound traffic from interstate ISP-bound traffic. We further seek comment on the technical and practical implications of requiring the separation of intrastate and interstate ISP-bound traffic. In addition, we seek comment on the implications of various proposals regarding inter-carrier compensation for ISP-bound traffic on the separations regime, such as the appropriate treatment of incumbent LEC revenues and payments associated with the delivery of such traffic. This Commission is mindful of concerns that our jurisdictional analysis may result in allocation to different jurisdictions of the costs and revenues associated with ISP-bound traffic,[98] and we wish to make clear that we have no intention of permitting such a mismatch to occur. With respect to current arrangements, we note that this order does not alter the long-standing determination that ESPs (including ISPs) can procure their connections to LEC

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[97] *Id.*

[98] *See* Letter from James Bradford Ramsay, Assistant General Counsel, National Association of Regulatory Utility Commissioners, to Magalie R. Salas, Secretary, FCC (December 14, 1998).

end offices under intrastate end-user tariffs, and thus for those LECs subject to jurisdictional separations both the costs and the revenues associated with such connections will continue to be accounted for as intrastate.

B. Procedural Matters.

1. Ex Parte Presentations.

37. This Notice of Proposed Rulemaking is a permit-but-disclose notice-and-comment rulemaking proceeding. *Ex Parte* presentations are permitted, in accordance with the Commission's rules, provided that they are disclosed as required.[99]

2. Initial Regulatory Flexibility Analysis.

38. As required by the Regulatory Flexibility Act (RFA),[100] the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the policies and rules proposed in the *Notice of Proposed Rulemaking* (*Notice*). Written public comments are requested on the IRFA. These comments must be filed by the deadlines for comment on the remainder of the *Notice*, and should have a separate and distinct heading designating them as responses to the IRFA. The Commission will send a copy of the *Notice*, including the IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA), in accordance with the RFA, 5 U.S.C. § 603(a).

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[99] *See generally* 47 C.F.R. §§ 1.1200, 1.1202, 1.1204, 1.1206.

[100] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 et seq., has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

39. *Need for and Objectives of the Proposed Rules.* We tentatively conclude that we should adopt a rule regarding inter-carrier compensation for ISP-bound traffic that strongly reflects our judgment that commercial negotiations are the ideal means of establishing the terms of interconnection contracts. We seek comment on two alternative proposals for implementing such a regime. Until adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic. In light of comments received in response to the *Notice*, we might issue new rules or alter existing rules.

40. *Legal Basis.* The legal basis for any action that may be taken pursuant to the *Notice* is contained in Sections 1, 2, 4, 201, 202, 274, and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154, 201, 202, 251, 252, and 303(r).

41. *Description and Estimate of the Number of Small Entities That May Be Affected by the Notice of Proposed Rulemaking.* The RFA directs the Commission to provide a description of and, where feasible, an estimate of the number of small entities that might be affected by proposed rules. The RFA defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small business concern" under Section 3 of the Small Business Act.[101] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria

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[101] *See* 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632). The Commission may also develop additional definitions that are appropriate to its activities.

established by SBA.[102] The SBA has defined a small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except Radiotelephone) to be an entity with no more than 1,500 employees.[103] Consistent with prior practice, we here exclude small incumbent local exchange carriers (LECs) from the definition of "small entity" and "small business concern."[104] Although such a company may have 1,500 or fewer employees and thus fall within the SBA's definition of a small telecommunications entity, such companies are either dominant in their field of operations or are not independently owned and operated. Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will consider small incumbent LECs within this present analysis and use the term "small incumbent LECs" to refer to any incumbent LEC that arguably might be defined by SBA as a small business concern.

42. *Total Number of Telephone Companies Affected.* The United States Bureau of the Census (the Census Bureau) reports that at the end of 1992, there were 3,497 firms engaged in providing telephone services, as defined therein, for at least one year.[105] This number includes a variety of different categories of carriers, including local exchange carriers (both incumbent and competitive), interexchange carriers, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, PCS providers, cov-

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[102] 15 U.S.C. § 632.

[103] *See* 13 C.F.R. § 121.201.

[104] *See, e.g., Local Competition Order*, 11 FCC Rcd at 16150.

[105] United States Department of Commerce, Bureau of the Census, *1992 Census of Transportation, Communications, and Utilities: Establishment and Firm Size*, at Firm Size 1-123 (1995) (1992 Census).

ered SMR providers, and resellers. It seems certain that some of those 3,497 telephone service firms may not qualify as small entities because they are not "independently owned or operated."[106] For example, a PCS provider that is affiliated with an interexchange carrier having more than 1,500 employees would not meet the definition of a small business. It seems reasonable to conclude, therefore, that fewer than 3,497 telephone service firms are either small entities or small incumbent LECs that may be affected by this *Notice*.

43. *Local Exchange Carriers.* Neither the Commission nor the SBA has developed a definition of small providers of local exchange services. The closest applicable definition under the SBA's rules is for telephone communications companies other than radiotelephone (wireless) companies. The most reliable source of information regarding the number of LECs nationwide of which we are aware appears to be the data that we collect annually in connection with the Telecommunications Relay Service (TRS).[107] According to our most recent data, 1,371 companies reported that they were engaged in the provision of local exchange services.[108] Although it seems certain that some of these carriers are not independently owned and operated, or have more than 1,500 employees, or are dominant, we are unable at this time to estimate with greater precision the number of LECs that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that fewer than 1,371 small providers of local exchange service are small entities or

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[106] 15 U.S.C. § 632(a)(1).

[107] FCC, *Telecommunications Industry Revenue: TRS Fund Worksheet Data*, Figure 2 (*Number of Carriers Paying into the TRS Fund by Type of Carrier*) (Nov. 1997).

[108] *Id.*

small incumbent LECs that may be affected by the *Notice*.

44. *Description of Projected Reporting, Recordkeeping and Other Compliance Requirements.* As a result of rules that we may adopt, incumbent LECs and CLECs may be required to discern the amount of traffic carried on their networks that is bound for ISPs. In addition, such incumbent LECs and entrants may be required to produce information regarding the costs of carrying ISP-bound traffic on their networks.

45. *Steps Taken to Minimize Significant Economic Impact on Small Entities, and Alternatives Considered.* As noted above, we propose to adopt rules that may require incumbent LECs and CLECs to discern the amount of traffic carried on their networks that is bound for ISPs.[109] We anticipate that if we adopt such rules, incumbent LECs and CLECs, including small entity incumbent LEC and CLECs, will be able to receive compensation for the delivery of ISP-bound traffic that they might not otherwise receive. The *Notice* also requests comment on alternative proposals.

46. *Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules.* None.

3. Comment Filing Procedures.

47. Pursuant to Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments on or before April 12, 1999, and reply comments on or before April 27, 1999. Comments

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[109] *See* ¶¶ 28-36, *supra*.

may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.[110]

48. Comments filed through the ECFS can be sent as an electronic file via the Internet to <http://www.fcc.gov/e-file/ecfs.html>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail message to ecfs@fcc.gov and include "get form <your e-mail address>" in the body of the message. A sample form and directions will be sent in reply.

49. Parties that choose to file by paper must file an original and four copies of each filing. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 Twelfth St., S.W., Room TW-A325, Washington, DC 20554.

50. Parties that choose to file by paper should also submit their comments on diskette. These diskettes should be submitted to: Wanda Harris, Federal Communications Commission, Common Carrier Bureau, Competitive Pricing Division, 445 Twelfth St., S.W., Fifth Floor, Washington, DC 20554. Such a submission should be on a 3.5 inch diskette formatted in an IBM compatible

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[110] *See Electronic Filing of Documents in Rulemaking Proceedings*, 63 Fed. Reg. 24,121 (1998).

format using WordPerfect 5.1 for Windows or compatible software. The diskette should be accompanied by a cover letter and should be submitted in "read only" mode. The diskette should be clearly labelled with the commenter's name, proceeding (including the docket number in this case, CC Docket No. 99-68); type of pleading (comment or reply comment); date of submission; and the name of the electronic file on the diskette. The label should also include the following phrase "Disk Copy - Not an Original." Each diskette should contain only one party's pleadings, preferably in a single electronic file. In addition, commenters must send diskette copies to the Commission's copy contractor, International Transcription Service, Inc., 1231 20th Street, N.W., Washington, DC 20036.

V. Ordering Clauses

51. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i) and (j), 201-209, 251, 252, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-209, 251, 252 and 403, that this Notice of Proposed Rulemaking IS HEREBY ADOPTED and comments ARE REQUESTED as described above.

52. IT IS FURTHER ORDERED that the Commission's Office of Public Affairs, Reference Operations Division, SHALL SEND a copy of this Notice of Proposed Rulemaking, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas

Secretary

SEPARATE STATEMENT OF COMMISSIONER SUSAN NESS

Re: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket 96-98); and Inter-carrier Compensation for ISP-Bound Traffic (CC Docket No. 99-68)

This proceeding is one of unusual importance and unusual complexity.

The debate over reciprocal compensation for ISP-bound traffic is *important* for three main reasons. First, the issues we review here involve access to the Internet, a unique, extraordinary, and ever-evolving national and international network of networks that is rapidly transforming communication, commerce, and communities. Second, reciprocal compensation may substantially affect the nature and the extent of local telephone competition, which was a principal objective of the Telecommunications Act of 1996. Third, any decision in this area may affect relationships between state and federal regulatory authorities, who must work in harmony to achieve successful implementation of the Telecommunications Act.

The debate is *complex* because it involves the application of legal precedents from the early 1980s to services and carrier arrangements that were unimaginable only a few short years ago, as well as provisions of the 1996 Act that have already led to considerable controversy and litigation. We must grapple with equities that may be quite different when viewed prospectively than when viewed retrospectively. A further complication is that reciprocal compensation involves certain issues that can better be assessed by state public utility commissions than by the FCC, and yet it also implicates important national interests affecting access to an interstate (and international) service.

At the end of the day, however, I believe the case boils down to elementary and straightforward propositions. Switched network telephone calls to Internet service providers are inherently interstate, which is the decision most consistent with our prior creation of an ESP exemption from interstate access charges—and with the interstate and international nature of the Internet. But to say this is *not* to overrule, undermine, or prevent state commission decisions that construe interconnection agreements to require reciprocal compensation for ISP-bound traffic. It was, and remains, reasonable for the states (and federal district courts) to so rule, given our prior decisions—and the practices of the ILECs themselves—to treat this traffic as local.[1]

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[1] Since 1983, the Commission has consistently and consciously permitted enhanced service providers, a category that now includes Internet service providers (ISPs) to connect to their customers using local business lines. *See, e.g.*, *MTS and WATS Market Structure*, 97 FCC 2d 682, 715, para. 83 (1983) (subsequent history omitted). Enhanced service providers use "*interstate* access" but pay "*local* business exchange service rates." *Id.* (emphasis added); *see also Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd. 2631, 2635 n.8 (1988) ("enhanced service providers generally pay *local* business rates and interstate subscriber line charges for their switched access connections to local exchange company central offices") (emphasis added); *accord id.* at 2637 n.53.

This decision was not altered by passage of the Telecommunications Act of 1996. After that law was passed, we expressly reiterated that ISPs "purchase services from incumbent LECs under the same *intrastate* tariffs available to end users" and determined that, if "*intrastate* rate structures fail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming calls, incumbent LECs may address their concerns to *state* regulators." *Access Charge Reform*, 12 FCC Rcd. 15982, 16132, para. 342 & 16135, para. 346 (1997), *aff'd Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (emphasis added).

And, although we are declaring that there are national interests that must be respected on a going-forward basis, it may well be that these interests can be protected without changing the long-standing decision to treat this traffic as local. One could readily imagine, for example, that states will not seek to assess per-minute fees on Internet-bound calls, just as the FCC has repeatedly resisted entreaties to do so. One can also reasonably foresee that, even if ISP-bound traffic continues to be handled by the state commissions under the usual 251/252 process, the parties themselves (in voluntarily negotiated agreements) or the state commissions (if called upon to arbitrate agreements between incumbents and new entrants) will in future agreements address the issues associated with ISP-bound traffic in ways that avoid some of the obvious anomalies and competitive distortions that may result from some of the current ILEC-CLEC arrangements.

In short, I believe the decision we have adopted is one that (1) comports with the law, (2) is fair both to incumbent local exchange carriers and to competitive local exchange carriers, (3) does not unravel the core determi-

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The Eighth Circuit explicitly recognized that the manner in which Internet-bound traffic is treated is a product of FCC "discretion." *Southwestern Bell Telephone*, 153 F.3d at 543. It is significant that, in the aforementioned *Access Charge Reform* proceeding, we implicitly affirmed both the FCC's ultimate authority over this traffic and the state commissions' competence to handle it unless and until directed otherwise. It is especially telling that the *Southwestern Bell Telephone* decision, acknowledging the Commission's ultimate authority over such inherently interstate traffic, came from a court that was otherwise quite resistant to FCC encroachment on matters that it deemed to be on the states' side of a "horse-high, hog-tight, and bull-strong fence." *Iowa Utilities Bd. v. FCC*, 120 F.3d 753, 800 (8th Cir. 1997), *rev'd in pertinent part*, *AT&T Corp. v. Iowa Utilities Bd.*, 119 S. Ct. 721 (1999).

nations of the more than two dozen state commissions that have addressed this issue, (4) sets the stage for future determinations that will eliminate or at least attenuate any anomalies inherent in current compensation arrangements, and (5) preserves this Commission's ability to safeguard the innovative, competitive, and unregulated character of the Internet. I hope that parties responding to the Notice of Proposed Rulemaking will focus on ways in which all of these objectives may continue to be advanced.

SEPARATE STATEMENT OF COMMISSIONER MICHAEL K. POWELL, CONCURRING

Re: Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98) and Inter-Carrier Compensation for ISP-Bound Traffic (CC Docket No. 99-68).

I write separately to explain the bases upon which I concur in this action. Specifically, based on the long inquiry that has led to our action today, I agree with the majority that LEC-to-LEC Internet-bound traffic is properly classified as jurisdictionally interstate. Because of this agreement, and in light of the serious governmental interests implicated, I believe it is appropriate for the Commission to consider whether the current method of determining intercarrier compensation for this traffic at the state level continues to be appropriate. I believe, however, that in a well-meaning effort to preserve existing state decisions regarding reciprocal compensation for this traffic, we have strayed into areas best left to state authorities and may have unwittingly muddled our jurisdictional analysis.

As the attached decision correctly points out, a number of the Commission's precedents indicate that the jurisdictional nature of communications should be determined by the end points of the communication (*i.e.*, by looking at the entire communication as "one call"). I believe this method of evaluating jurisdiction remains valid and important, especially considering the growing number of creative and complex methods for transmitting and transporting communications. Indeed, the challenge of packet networks is that they make it nearly impossible

(at present) to trace accurately the route of a single communication to its destination, especially given that each packet of which the communication is comprised may take a different route before reassembling at the intended destination. These and other technological developments will continue to frustrate traditional geographic boundaries.

Our decision that LEC-to-LEC Internet-bound traffic is interstate in nature fundamentally calls into question a number of state decisions that applied reciprocal compensation to LEC-to-LEC Internet-bound traffic based primarily or exclusively on the view, which we herein reject, that this traffic is local. I agree with the majority that this conclusion does not, in itself, dictate how or whether carriers of this traffic should be compensated, nor does this conclusion determine whether this Commission or state commissions should establish compensation arrangements. I likewise agree that not all state decisions to apply reciprocal compensation to this traffic share this basis, and that, as a general matter, there may be other bases upon which state commissions could continue these compensation schemes even after the action we take here.

But even given the fact that our decision today does not necessarily undermine each of the state decisions, I think the most prudent course would have been for us to decline to speculate on what bases there may be for upholding those decisions. The decisions themselves are not before us and it is properly for state authorities to explore the ramifications of our action today on those decisions. Furthermore, having reviewed a number of the state decisions in this area, I am persuaded that the underlying facts, analytical underpinnings and applicable law vary enormously from state to state. We cannot,

even in the most carefully worded or sweeping dicta, address all of these variations meaningfully.

That said, I might support some of the majority's suggested rationales for preserving existing state decisions, but cannot embrace others because I am unpersuaded either that they are sensitive to the wide variations in the facts, analysis and legal contexts or that the benefits of such rationales substantially exceed their potential risks. I put in the first category the view that state decisions applying reciprocal compensation to LEC-to-LEC Internet-bound traffic should be preserved where the state or reviewing court finds that the parties *agreed* to compensate each other for this traffic in this way. Sections 251 and 252 of the Act express a clear preference for negotiations as the primary method for carriers to determine the terms of interconnection, and the Act allows parties to agree even to terms that do not satisfy the requirements of these sections. Thus, I firmly believe that if a state commission or court interpreting state law determines that carriers agreed to apply reciprocal compensation to this traffic, those carriers should be held to the terms of their agreement. Furthermore, I have no strong objection to our dicta to the extent it suggests that state commissions or reviewing courts may identify other justifications for preserving state decisions to apply reciprocal compensation to this traffic under state law. If we had included only this rationale as a basis upon which states could uphold their existing decisions, my concerns with our decision today would have been significantly reduced.

But rather than merely acknowledging generally the possibility of state law bases on which we believe such agreements can be sustained, we have chosen to proffer other specific bases. I am concerned, however, that the

other theories proffered here are legally and analytically unsound, may prospectively hinder our ability to address the public policy concerns that led us to assert jurisdiction here in the first place, and yet do very little retroactively to preserve state-sanctioned agreements. As such, I decline to subscribe to certain of the dicta in our decision.

First, I decline to subscribe to any suggestion that the state decisions could be preserved based on the theory that we had essentially delegated responsibility to state commissions to approve or determine compensation arrangements for LEC-to-LEC Internet-bound traffic. Unquestionably, we have in the past declined to apply certain types of existing federal compensation or charges to traffic flowing to enhanced service providers (ESPs) from individual LECs. As the decision appears to acknowledge, however, we have never made a conscious, affirmative choice to defer in similar fashion to local compensation measures for the situation we face here (*i.e.*, intercarrier compensation for LEC-to-LEC Internet-bound traffic). I do not question that a state may have understandably analogized the ESP precedent to this case. But no matter how apt the analogy to the facts before us now, one cannot assume delegated authority by analogy. Thus, I cannot support any suggestion that the Commission has heretofore delegated authority to state commissions to impose reciprocal compensation on this traffic.

Second, I decline to subscribe to the dicta in this decision to the extent it suggests that the state decisions can be preserved because state commissions and this Commission share jurisdiction for implementing the sections 251 and 252 of the Act.

I fully agree that the states, to the extent they acted pursuant to their statutory obligation to arbitrate and approve interconnection agreements, acted reasonably in the absence of a clear federal rule. Nonetheless, I fail to see how such reasonableness will be a defense to claims that our jurisdictional analysis conflicts with that of a state. Such reasonableness does little to preserve those state decisions most likely to be disturbed by our "one call" jurisdictional analysis, namely, decisions based primarily or exclusively on a "two call" theory. In short, I think touching on the issue of shared jurisdiction muddles our conclusion that there is federal jurisdiction with respect to these questions.[1] I remain open to considering any reasonable compensation scheme (including delegating authority to states) but would have preferred to do so on the basis of our interstate authority, rather than on shared jurisdiction.

In closing, I wish to note that I would have preferred to avoid making tentative conclusions in the Notice section of today's decision. Indeed, in light of the complexity

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[1] Any shared jurisdiction theory raises certain questions, such as: what are the limits of federal authority in crafting a compensation regime? Although the recent Supreme Court decision in *AT&T Corp. v. Iowa Utilities Board* begins to answer this question, the Court's answer may not be entirely complete. For example, in affirming the Commission's pricing jurisdiction, the Court states: "While it is true that the 1996 Act entrusts state commissions with the job of approving interconnection agreements . . . and granting exemptions to rural LECs, . . . these assignments . . . do not logically preclude the Commission's issuance of rules *to guide the state commission judgments*." *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999) (opinion of the court, section II) (emphasis added). Other than affirming the approach taken in the Commission's underlying order, however, the Court provided little guidance regarding the level of specificity with which the Commission can "guide the state commission judgments."

of the analysis, the importance of the issues and the long inquiry leading up to this decision, some may find it strange that our tentative conclusion in favor of state-level arbitrations would leave the method of establishing intercarrier compensation for this traffic virtually unchanged. I encourage commenters to provide information on both sides of this important issue so that we can assess more fully which compensation scheme is best.

For these reasons, I cannot fully support our decision today, and thus I concur in it. I wish to commend, however, my colleagues and our dedicated staff for their diligence and patience in wrestling with these knotty legal and policy issues.

APPENDIX L
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 08-1365
Consolidated with 08-1393, 09-1044, 09-1046
September Term 2009
FCC-08-262

Core Communications, Inc.,
Petitioner,

v.

Federal Communications Commission and United States of America,
Respondents.

Earthlink, Inc., et al.,
Intervenors,

Filed On: March 26, 2010

Before: Sentelle, Chief Judge, and Williams and Randolph, Senior Circuit Judge

ORDER

Upon consideration of the petition of petitioner Core Communications, Inc. and Intervenor 01 Communications, Inc. and the petition of Pennsylvania Public Utilities Commission for panel rehearing filed on March 1 and March 3, 2010, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/
Michael C. McGrail
Deputy Clerk

APPENDIX M
IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 08-1365
Consolidated with 08-1393, 09-1044, 09-1046
September Term 2009
FCC-08-262

Core Communications, Inc.,
Petitioner,

v.

Federal Communications Commission
and United States of America,
Respondents.

Earthlink, Inc., et al.,
Intervenors,

Filed On: March 26, 2010

Before: Sentelle, Chief Judge, Ginsburg, Henderson,* Rogers, Tatel, Garland, Brown,* Griffith, Kavanaugh, Circuit Judges, and Williams and Randolph, Senior Circuit Judges

ORDER

Upon consideration of the petition of petitioner Core Communications, Inc. and Intervenor 01 Communications, Inc. and the petition of Pennsylvania Public Utilities Commission for panel rehearing en banc, and the

absence of a request by any member of the court for a vote, it is

ORDERED that the petitions be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/
Michael C. McGrail
Deputy Clerk

* Circuit Judges Henderson and Brown did not participate in this matter.

APPENDIX N
RELEVANT STATUTORY PROVISIONS

The Communications Act of 1934, as amended by the Telecommunications Act of 1996, 47 U.S.C. §§ 151 *et seq.*, provides in relevant part as follows:

* * * * *

§ 201. Service and charges

(a) It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

(b) All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful: *Provided*, That communications by wire or radio subject to this chapter may be classified into day, night, repeated, unrepeated, letter, commercial, press, Government, and such other classes as the Commission may decide to be just and reasonable, and different charges may be made for the different classes of communications: *Provided further*, That nothing in this chapter or in any other provision of law shall be construed to prevent a common carrier subject to this chapter from entering into or operating under any contract with any common carrier not subject to this

chapter, for the exchange of their services, if the Commission is of the opinion that such contract is not contrary to the public interest: *Provided further*, That nothing in this chapter or in any other provision of law shall prevent a common carrier subject to this chapter from furnishing reports of positions of ships at sea to newspapers of general circulation, either at a nominal charge or without charge, provided the name of such common carrier is displayed along with such ship position reports. The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter.

* * * * *

§ 251. Interconnection

(a) General duty of telecommunications carriers

Each telecommunications carrier has the duty—

(1) to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers; and

(2) not to install network features, functions, or capabilities that do not comply with the guidelines and standards established pursuant to section 255 or 256 of this title.

(b) Obligations of all local exchange carriers

Each local exchange carrier has the following duties:

(1) Resale

The duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services.

(2) Number portability

The duty to provide, to the extent technically feasible, number portability in accordance with requirements prescribed by the Commission.

(3) Dialing parity

The duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service, and the duty to permit all such providers to have nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.

(4) Access to rights-of-way

The duty to afford access to the poles, ducts, conduits, and rights-of-way of such carrier to competing

providers of telecommunications services on rates, terms, and conditions that are consistent with section 224 of this title.

(5) Reciprocal compensation

The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.

(c) Additional obligations of incumbent local exchange carriers

In addition to the duties contained in subsection (b) of this section, each incumbent local exchange carrier has the following duties:

(1) Duty to negotiate

The duty to negotiate in good faith in accordance with section 252 of this title the particular terms and conditions of agreements to fulfill the duties described in paragraphs (1) through (5) of subsection (b) of this section and this subsection. The requesting telecommunications carrier also has the duty to negotiate in good faith the terms and conditions of such agreements.

(2) Interconnection

The duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network—

(A) for the transmission and routing of telephone exchange service and exchange access;

(B) at any technically feasible point within the carrier's network;

(C) that is at least equal in quality to that provided by the local exchange carrier to itself or to

any subsidiary, affiliate, or any other party to which the carrier provides interconnection; and

(D) on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title.

(3) Unbundled access

The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

(4) Resale

The duty—

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at

wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.

(5) Notice of changes

The duty to provide reasonable public notice of changes in the information necessary for the transmission and routing of services using that local exchange carrier's facilities or networks, as well as of any other changes that would affect the interoperability of those facilities and networks.

(6) Collocation

The duty to provide, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, for physical collocation of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier, except that the carrier may provide for virtual collocation if the local exchange carrier demonstrates to the State commission that physical collocation is not practical for technical reasons or because of space limitations.

(d) Implementation

(1) In general

Within 6 months after February 8, 1996, the Commission shall complete all actions necessary to establish regulations to implement the requirements of this section.

(2) Access standards

In determining what network elements should be made available for purposes of subsection (c)(3) of this

section, the Commission shall consider, at a minimum, whether—

(A) access to such network elements as are proprietary in nature is necessary; and

(B) the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

(3) Preservation of State access regulations

In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that—

(A) establishes access and interconnection obligations of local exchange carriers;

(B) is consistent with the requirements of this section; and

(C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.

(e) Numbering administration

(1) Commission authority and jurisdiction

The Commission shall create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. The Commission shall have exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States. Nothing in this paragraph shall preclude the Commission from delegating to State commissions or other entities all or any portion of such jurisdiction.

(2) Costs

The cost of establishing telecommunications numbering administration arrangements and number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission.

(3) Universal emergency telephone number

The Commission and any agency or entity to which the Commission has delegated authority under this subsection shall designate 9-1-1 as the universal emergency telephone number within the United States for reporting an emergency to appropriate authorities and requesting assistance. The designation shall apply to both wireline and wireless telephone service. In making the designation, the Commission (and any such agency or entity) shall provide appropriate transition periods for areas in which 9-1-1 is not in use as an emergency telephone number on October 26, 1999.

(f) Exemptions, suspensions, and modifications

(1) Exemption for certain rural telephone companies

(A) Exemption

Subsection (c) of this section shall not apply to a rural telephone company until (i) such company has received a bona fide request for interconnection, services, or network elements, and (ii) the State commission determines (under subparagraph (B)) that such request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 of this title (other than subsections (b)(7) and (c)(1)(D) thereof).

(B) State termination of exemption and implementation schedule

The party making a bona fide request of a rural telephone company for interconnection, services, or network elements shall submit a notice of its request to the State commission. The State commission shall conduct an inquiry for the purpose of determining whether to terminate the exemption under subparagraph (A). Within 120 days after the State commission receives notice of the request, the State commission shall terminate the exemption if the request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 of this title (other than subsections (b)(7) and (c)(1)(D) thereof). Upon termination of the exemption, a State commission shall establish an implementation schedule for compliance with the request that is consistent in time and manner with Commission regulations.

(C) Limitation on exemption

The exemption provided by this paragraph shall not apply with respect to a request under subsection (c) of this section, from a cable operator providing video programming, and seeking to provide any telecommunications service, in the area in which the rural telephone company provides video programming. The limitation contained in this subparagraph shall not apply to a rural telephone company that is providing video programming on February 8, 1996.

(2) Suspensions and modifications for rural carriers

A local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide may petition a State commission for a suspension or modification of the application of a requirement or requirements of subsection (b) or (c) of this section to telephone exchange service facilities specified in such petition. The State commission shall grant such petition to the extent that, and for such duration as, the State commission determines that such suspension or modification—

(A) is necessary—

(i) to avoid a significant adverse economic impact on users of telecommunications services generally;

(ii) to avoid imposing a requirement that is unduly economically burdensome; or

(iii) to avoid imposing a requirement that is technically infeasible; and

(B) is consistent with the public interest, convenience, and necessity.

The State commission shall act upon any petition filed under this paragraph within 180 days after receiving such petition. Pending such action, the State commission may suspend enforcement of the requirement or requirements to which the petition applies with respect to the petitioning carrier or carriers.

(g) Continued enforcement of exchange access and interconnection requirements

On and after February 8, 1996, each local exchange carrier, to the extent that it provides wireline services,

shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996, under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996. During the period beginning on February 8, 1996, and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

(h) "Incumbent local exchange carrier" defined

(1) Definition

For purposes of this section, the term "incumbent local exchange carrier" means, with respect to an area, the local exchange carrier that—

(A) on February 8, 1996, provided telephone exchange service in such area; and

(B)(i) on February 8, 1996, was deemed to be a member of the exchange carrier association pursuant to section 69.601(b) of the Commission's regulations (47 C.F.R. 69.601(b)); or

(ii) is a person or entity that, on or after February 8, 1996, became a successor or assign of a member described in clause (i).

(2) Treatment of comparable carriers as incumbents

The Commission may, by rule, provide for the treatment of a local exchange carrier (or class or

category thereof) as an incumbent local exchange carrier for purposes of this section if—

(A) such carrier occupies a position in the market for telephone exchange service within an area that is comparable to the position occupied by a carrier described in paragraph (1);

(B) such carrier has substantially replaced an incumbent local exchange carrier described in paragraph (1); and

(C) such treatment is consistent with the public interest, convenience, and necessity and the purposes of this section.

(i) Savings provision

Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201 of this title.

§ 252. Procedures for negotiation, arbitration, and approval of agreements

(a) Agreements arrived at through negotiation

(1) Voluntary negotiations

Upon receiving a request for interconnection, services, or network elements pursuant to section 251 of this title, an incumbent local exchange carrier may negotiate and enter into a binding agreement with the requesting telecommunications carrier or carriers without regard to the standards set forth in subsections (b) and (c) of section 251 of this title. The agreement shall include a detailed schedule of itemized charges for interconnection and each service or network element included in the agreement. The agreement, including any interconnection agreement negotiated before February 8, 1996, shall be submitted to the State commission under subsection (e) of this section.

(2) Mediation

Any party negotiating an agreement under this section may, at any point in the negotiation, ask a State commission to participate in the negotiation and to mediate any differences arising in the course of the negotiation.

(b) Agreements arrived at through compulsory arbitration

(1) Arbitration

During the period from the 135th to the 160th day (inclusive) after the date on which an incumbent local exchange carrier receives a request for negotiation under this section, the carrier or any other party to the negotiation may petition a State commission to arbitrate any open issues.

(2) Duty of petitioner

(A) A party that petitions a State commission under paragraph (1) shall, at the same time as it submits the petition, provide the State commission all relevant documentation concerning –

(i) the unresolved issues;

(ii) the position of each of the parties with respect to those issues; and

(iii) any other issue discussed and resolved by the parties.

(B) A party petitioning a State commission under paragraph (1) shall provide a copy of the petition and any documentation to the other party or parties not later than the day on which the State commission receives the petition.

(3) Opportunity to respond

A non-petitioning party to a negotiation under this section may respond to the other party's petition and provide such additional information as it wishes within 25 days after the State commission receives the petition.

(4) Action by State commission

(A) The State commission shall limit its consideration of any petition under paragraph (1) (and any response thereto) to the issues set forth in the petition and in the response, if any, filed under paragraph (3).

(B) The State commission may require the petitioning party and the responding party to provide such information as may be necessary for the State commission to reach a decision on the unresolved issues. If any party refuses or fails unreasonably to

respond on a timely basis to any reasonable request from the State commission, then the State commission may proceed on the basis of the best information available to it from whatever source derived.

(C) The State commission shall resolve each issue set forth in the petition and the response, if any, by imposing appropriate conditions as required to implement subsection (c) of this section upon the parties to the agreement, and shall conclude the resolution of any unresolved issues not later than 9 months after the date on which the local exchange carrier received the request under this section.

(5) Refusal to negotiate

The refusal of any other party to the negotiation to participate further in the negotiations, to cooperate with the State commission in carrying out its function as an arbitrator, or to continue to negotiate in good faith in the presence, or with the assistance, of the State commission shall be considered a failure to negotiate in good faith.

(c) Standards for arbitration

In resolving by arbitration under subsection (b) of this section any open issues and imposing conditions upon the parties to the agreement, a State commission shall—

(1) ensure that such resolution and conditions meet the requirements of section 251 of this title, including the regulations prescribed by the Commission pursuant to section 251 of this title;

(2) establish any rates for interconnection, services, or network elements according to subsection (d) of this section; and

(3) provide a schedule for implementation of the terms and conditions by the parties to the agreement.

(d) Pricing standards

(1) Interconnection and network element charges

Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251 of this title, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section—

(A) shall be—

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and

(ii) nondiscriminatory, and

(B) may include a reasonable profit.

(2) Charges for transport and termination of traffic

(A) In general

For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5) of this title, a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless—

(i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and

(ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls.

(B) Rules of construction

This paragraph shall not be construed—

(i) to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements); or

(ii) to authorize the Commission or any State commission to engage in any rate regulation proceeding to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls.

(3) Wholesale prices for telecommunications services

For the purposes of section 251(c)(4) of this title, a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

(e) Approval by State commission

(1) Approval required

Any interconnection agreement adopted by negotiation or arbitration shall be submitted for approval to the State commission. A State commission to which an agreement is submitted shall approve or

reject the agreement, with written findings as to any deficiencies.

(2) Grounds for rejection

The State commission may only reject—

(A) an agreement (or any portion thereof) adopted by negotiation under subsection (a) of this section if it finds that—

(i) the agreement (or portion thereof) discriminates against a telecommunications carrier not a party to the agreement; or

(ii) the implementation of such agreement or portion is not consistent with the public interest, convenience, and necessity; or

(B) an agreement (or any portion thereof) adopted by arbitration under subsection (b) of this section if it finds that the agreement does not meet the requirements of section 251 of this title, including the regulations prescribed by the Commission pursuant to section 251 of this title, or the standards set forth in subsection (d) of this section.

(3) Preservation of authority

Notwithstanding paragraph (2), but subject to section 253 of this title, nothing in this section shall prohibit a State commission from establishing or enforcing other requirements of State law in its review of an agreement, including requiring compliance with intrastate telecommunications service quality standards or requirements.

(4) Schedule for decision

If the State commission does not act to approve or reject the agreement within 90 days after submission

by the parties of an agreement adopted by negotiation under subsection (a) of this section, or within 30 days after submission by the parties of an agreement adopted by arbitration under subsection (b) of this section, the agreement shall be deemed approved. No State court shall have jurisdiction to review the action of a State commission in approving or rejecting an agreement under this section.

(5) Commission to act if State will not act

If a State commission fails to act to carry out its responsibility under this section in any proceeding or other matter under this section, then the Commission shall issue an order preempting the State commission's jurisdiction of that proceeding or matter within 90 days after being notified (or taking notice) of such failure, and shall assume the responsibility of the State commission under this section with respect to the proceeding or matter and act for the State commission.

(6) Review of State commission actions

In a case in which a State fails to act as described in paragraph (5), the proceeding by the Commission under such paragraph and any judicial review of the Commission's actions shall be the exclusive remedies for a State commission's failure to act. In any case in which a State commission makes a determination under this section, any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements of section 251 of this title and this section.

(f) Statements of generally available terms

(1) In general

A Bell operating company may prepare and file with a State commission a statement of the terms and conditions that such company generally offers within that State to comply with the requirements of section 251 of this title and the regulations thereunder and the standards applicable under this section.

(2) State commission review

A State commission may not approve such statement unless such statement complies with subsection (d) of this section and section 251 of this title and the regulations thereunder. Except as provided in section 253 of this title, nothing in this section shall prohibit a State commission from establishing or enforcing other requirements of State law in its review of such statement, including requiring compliance with intrastate telecommunications service quality standards or requirements.

(3) Schedule for review

The State commission to which a statement is submitted shall, not later than 60 days after the date of such submission—

(A) complete the review of such statement under paragraph (2) (including any reconsideration thereof), unless the submitting carrier agrees to an extension of the period for such review; or

(B) permit such statement to take effect.

(4) Authority to continue review

Paragraph (3) shall not preclude the State commission from continuing to review a statement that has been permitted to take effect under subpara-

graph (B) of such paragraph or from approving or disapproving such statement under paragraph (2).

(5) Duty to negotiate not affected

The submission or approval of a statement under this subsection shall not relieve a Bell operating company of its duty to negotiate the terms and conditions of an agreement under section 251 of this title.

(g) Consolidation of State proceedings

Where not inconsistent with the requirements of this chapter, a State commission may, to the extent practical, consolidate proceedings under sections 214(e), 251(f), 253 of this title, and this section in order to reduce administrative burdens on telecommunications carriers, other parties to the proceedings, and the State commission in carrying out its responsibilities under this chapter.

(h) Filing required

A State commission shall make a copy of each agreement approved under subsection (e) of this section and each statement approved under subsection (f) of this section available for public inspection and copying within 10 days after the agreement or statement is approved. The State commission may charge a reasonable and nondiscriminatory fee to the parties to the agreement or to the party filing the statement to cover the costs of approving and filing such agreement or statement.

(i) Availability to other telecommunications carriers

A local exchange carrier shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement.

(j) "Incumbent local exchange carrier" defined

For purposes of this section, the term "incumbent local exchange carrier" has the meaning provided in section 251(h) of this title.

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